TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 238

THE UNITED STATES OF AMERICA, PETITIONER

vs.

STATE OF NEW YORK

No. 251

STATE OF NEW YORK, PETITIONER

vs.

THE UNITED STATES OF AMERICA

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI IN NO. 238 FILED JULY 5, 1941
PETITION FOR CERTIORARI IN NO. 251 FILED JULY 9, 1941
CERTIORARI GRANTED OCTOBER 13, 1941

SUPREME COURT OF THE UNITED STATES

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ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

INDEX

1 In the United States Circuit Court of Appeals for the Second Circuit

In Bankruptcy No. 27444

In the Matter of INDEPENDENT AUTOMOBILE FORWARDING CORPORATION, BANKRUPT

STATE OF NEW YORK, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Statement Under Rule XIII

By order of the District Court for the Western District of New York, entered on the 26th day of April 1938, the above-named corporation was adjudged a bankrupt and Claire M. Britt was appointed trustee in liquidation. Priority claims were filed by the appellee as follows:

Taxes under Titles VIII and IX of the Social Security Act	$7,036.98
1937 Capital Stock tax	307.13

Priority claims were filed by the appellant as follows:

Taxes under Sections 183 and 184 of the Tax Law	$2,720.80
Taxes under Article 18 of the Labor Law	3,305.82

By stipulation, dated June 9, 1939, between the Attorney for the United States and Attorney for the State of New York the objections raised by the State of New York to claims of the United States were submitted to Honorable John Knight, United States District Judge for the Western District of New York, in the first instance. Order, dated June 19, 1939, allowed claims of the

2 United States in full. Order allowing appeal by the State of New York to this Court was signed by Honorable John Knight on July 24, 1939. Thereafter and by reason of the amendments to the Social Security Act, enacted August 10, 1939, stipulation was entered into by and between the Attorney for the State of New York and the Attorney for the United States in pursuance of which an order was made by the Honorable Learned Hand, Chief Judge of this Court, discontinuing said appeal and remanding the case to the District Court for the Western District of New York for resettlement of the order of June 23, 1939, in accordance with the amendments to the Social Security Act, enacted August 10, 1939.

This appeal is from the resettled order of the United States District Court for the Western District of New York, Honorable John Knight, United States District Judge, presiding, dated and entered in the office of the Clerk on July 15, 1940. Notice of Ap-

peal, dated July 21, 1940, was filed with the Clerk of the United States District Court for the Western District of New York on July 31, 1940.

No question was referred to any Commissioner, Master, or Referee.

The Attorney for the appellant, State of New York, is John J. Bennett, Jr.; the attorneys for the trustees, Claire M. Britt and Fred L. Hewitt, Jr., are Harter & Schork, Prudential Building, Buffalo, New York; Attorney for the appellee, United States of America, George L. Grobe, United States Attorney in and for the Western District of New York.

The names of the parties in this proceeding are set forth above. There has been no change of parties or attorneys since the commencement of this action.

3 In United States District Court, Western District of New York

[Title omitted.]

Notice of Appeal

July 21, 1940

Sirs:

Please take notice that the State of New York, claimant in the above proceeding, hereby appeals to the Circuit Court of Appeals for the Second Circuit from the Order of the United States District Court for the Western District of New York, dated July 15, 1940, and entered in the office of the Clerk of the said Court, in the above entitled cause on July 15, 1940, and from each and every part of said Order.

Dated, Albany, N. Y., July 21, 1940.

Yours, etc.,

JOHN J. BENNETT, JR.,
Attorney General,
Attorney for the State of New York,
Office and P. O. Address, Capitol, Albany, N. Y.
W. GERARD RYAN,
Assistant Attorney General.

4 To:

Hon. GEORGE L. GROBE,
United States Attorney,
502 U. S. Court House, Buffalo, New York.

HARTER AND SCHORK, Esqs.,
Attorneys for Trustee,
Prudential Building, Buffalo, New York.

CLERK, *United States District Court,*
For the Western District of New York,
United States Court House, Buffalo, New York.

In United States District Court

Order Appealed From

July 15, 1940

It appearing that the State of New York, claimant in the above proceeding, duly appealed from an order of this Court entered in the above proceeding on June 23, 1939, and it further appearing that thereafter and in accordance with a stipulation entered into by and between the attorneys for the State of New York, claimant-appellant, and the United States of America as appellee, an order was made and entered on February 7, 1940, by the Hon. Learned Hand, Chief Judge of the United States Circuit Court of Appeals, for the Second Circuit, discontinuing said appeal, and remanding the case to the District Court for the Western District of New York for the resettlement of the order of said District Court hereinabove mentioned and entered on June 23, 1939, in accordance with and in view of the amendments to the Social Security Act, enacted and effective August 10, 1939, and it further appearing that in accordance with said stipulation and the said order of the United States Circuit Court of Appeals for the Second Circuit, said matter was brought on for a hearing before the Hon. John Knight, United States District Judge in and for the Western District of New York, and after hearing John J. Bennett, Jr., Attorney General, attorney for the State of New York, claimant (Vincent Tauriello, Esq., of counsel), and George L. Grobe, United States Attorney in and for the Western District of New York, attorney for the United States of America, also a claimant in said proceeding, and due deliberation having been had thereon, and the opinion of this Court having been rendered and filed under date of July 5, 1940, now, therefore, on motion of George L. Grobe, United States Attorney in and for the Western District of New York, attorney for the United States of America, claimant in the above proceeding, it is hereby

Ordered that the balance on hand in the custody of the Trustee in the above proceeding, consisting of $3,053.19, be paid out and distributed to the United States of America and the State of New York on the respective claims of said sovereignties for taxes filed in said proceeding in the amounts set out below, viz:

United States of America, claim for Title IX, Social Security taxes	$660.10
United States of America, for all other tax claims filed in said proceeding	828.14
State of New York on its claim for unemployment compensation contributions	858.42
State of New York on all other tax claims	706.53

6 Checks in payment therefor with respect to the claims of the United States of America to be made payable to George T. McGowan, Collector of Internal Revenue for the 28th Collection District of New York, who filed the claims in this proceeding for taxes on behalf of the United States, and the checks in payment of claims of the State of New York to be made payable to the State of New York.

Dated: July 15, 1940.

JOHN KNIGHT,
United States District Judge.

In United States District Court

Petition of Claire M. Britt, Trustee

To the Honorable Justice of the United States District Court for the Western District of New York:

The Petition of Claire M. Britt, as Trustee in Liquidation of the above corporation, respectfully shows to this Court:

1. That your petitioner was duly appointed Trustee to liquidate the above-named corporation by Order of this Court entered on the 26th day of April 1938; that thereafter he duly qualified and acted and still is acting as such Trustee.

2. That under date of January 16, 1939, petitioner presented to this Court a petition setting forth in detail all of the acts and proceedings taken by this Petitioner in the Liquidation of this Estate; that such petition further set forth Petitioner's account of receipts and disbursements of Petitioner as such Trustee in

7 Liquidation; that on the basis of such petition this Court did, by Order entered on the 19th day of January 1939, direct that a hearing be had on the matters presented in the petition on February 6, 1939 and further directed that notice of such hearing be given to all creditors, stockholders and other persons interested in the Estate of the debtor; that such notice was duly given and the matter came on to be heard on such 6th day of February 1939 at which time this Court directed that the matter be adjourned and heard generally.

3. That on the 15th day of March 1939, an Order was made and entered herein approving and confirming the action of the Petitioner as Trustee in the administration and liquidation of this Estate, authorizing the settlement of the claim against the Patriotic Insurance Company for the sum of $600.00 and directing payment by Petitioner of his fee as Trustee and further directing payment to J. Francis Harter, Attorney, for fees and disbursements rendered in this proceeding and directing that the balance remaining after the making of such disbursements be retained by Petitioner, subject to further order of this Court.

4. That thereafter Petitioner performed the various acts and made the various disbursements as directed in such Order and at the present time is now holding in his hands as Trustee herein the sum of $3,053.20 to be distributed as directed by this Court.

5. That such sum of $3,053.20 is being held by Petitioner for payment to the priority creditors herein as may be directed by this Court; that such priority creditors are as follows:

United States Department of Internal Revenue, for unpaid contributions under Titles 8 and 9 of the Social Security Act, $7,036.98.

8 United States Department of Internal Revenue, 1937 Capital Stock Tax, $307.13.

New York State Department of Taxation and Finance claim for Franchise Taxes under Sections 183 and 184 of the Tax Law, $2,720.80.

New York State Unemployment Insurance Fund claim for unpaid contributions due under the Unemployment Insurance Law, $3,305.82.

6. That as appears from the above the amount of priority claims filed herein greatly exceed the amount on hand available for distribution to the priority creditors; that dispute has arisen between the United States Department of Internal Revenue and the New York State Department of Taxation and Finance as to the method of distribution of such assets remaining on hand in this Estate and as to the order of priority of the claims filed herein.

7. That the sole remaining duty and action to be performed by Petitioner in the Liquidation of this Estate is the distribution and payment of such sum remaining in Petitioner's hands; that accordingly Petitioner requests direction from this Court determining the order of priority of the various priority claims filed herein and directing the payment of the sum remaining in petitioner's hands to such of the priority creditors as may in the judgment of this Court be entitled thereto.

Wherefore, your Petitioner respectfully requests that the creditors who have filed priority claims herein be directed to show cause why an Order should not be made and entered herein determining the order of priority of the various priority claims filed herein and directing the payment and distribution of the balance

9 remaining in Petitioner's hands as Trustee in Liquidation and why upon the making of such payment and distribution as ordered by this Court the Petitioner and his surety herein should not be discharged from all further responsibility and liability as such Trustee in Liquidation and surety respectively.

CLAIRE M. BRITT,
Petitioner.

[*Duly sworn to by Claire M. Britt; jurat omitted in printing.*]

10 In the United States Circuit Court of Appeals

Stipulation

Dated February 1, 1940

[Title omitted.]

Whereas, an order, dated Buffalo, New York, July 24, 1939, by Honorable John Knight, United States District Judge for the Western District of New York, having been made granting the motion of John J. Bennett, Jr., Attorney General, Attorney for the State of New York for leave to appeal to the Circuit Court of Appeals for the Second Circuit from an order made by the United States District Judge for the Western District of New York on June 23, 1939, ordering, that the claim of the United States be allowed in full, and that the United States and the State of New York share in pari passu in the fund remaining in the hands of the Trustee, and

Whereas, an amendment to the Social Security Act having been enacted on August 10, 1939, providing as follows:

"SECTION 902. (a) Against the tax imposed by section 901
11 of the Social Security Act for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law— * * *

"(3) Without regard to the date of payment, if the assets of the taxpayers are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction."

Now, therefore, it is hereby stipulated that the appeal in the above entitled matter be discontinued without costs to either party upon condition that an order be made by the Circuit Court of Appeals for the Second Circuit remanding the case to the District Court for the Western District of New York and directing that the order dated June 23, 1939, be resettled in accordance with the amendments to the Social Security Act enacted August 10, 1939.

Dated, February 1st, 1940.

(S) JOHN J. BENNETT, Jr.,
W. G. R.
John J. Bennett, Jr.,
Attorney General,
Attorney for Appellant.

(S) GEORGE L. GROBE,
George L. Grobe,
United States Attorney,
Attorney for Appellee.

In United States Circuit Court of Appeals

Order Discontinuing Appeal and Remanding Cause

February 7, 1940

A stipulation having been made by John J. Bennett, Jr., Attorney General, Attorney for the State of New York, Appellant, and George L. Grobe, Attorney for the United States, Appellee, discontinuing the appeal in the above entitled matter without costs to either party on condition that the case be remanded to the District Court for the Western District of New York for resettlement of the order made by the United States District Judge for the Western District of New York on June 23, 1939, in accordance with the provisions of the amendment to the Social Security Act enacted August 10, 1939;

Upon consideration thereof it is,

Ordered that the appeal in the above-entitled matter hereby is discontinued without costs to either party and the case remanded to the District Court for the Western District of New York for the resettlement of the order made by the United States District Judge for the Western District of New York, on June 23, 1939, in accordance with the amendment to the Social Security Act enacted August 10, 1939.

Dated, February 7th, 1940.

(S) LEARNED HAND, *U. S. C. J.*.

13 In United States District Court

[Title omitted.]

Opinion

July 5, 1940

Appearances: George L. Grobe, United States Attorney, by Joseph J. Doran, Assistant United States Attorney; for government. John J. Bennett, Jr., Attorney General, State of New York; Vincent A. Tauriello, W. Gerard Ryan, and Francis R. Curran, of counsel; for State of New York.

KNIGHT, District Judge:

The issue here presented is the manner of distribution of the sum of $3,053.20 remaining in the bankrupt estate. Priority claims of the United States and the State of New York for taxes will absorb the entire amount. Claims in favor of the former have been allowed as follows:

Social Security Taxes under Section IX	$3,400.49
Other Federal Taxes	3,189.19

Claims of the State were allowed as follows:

Unemployment Insurance	$3,305.82
Other State Taxes	2,720.80

Under Section 902 of the Social Security Act, in cases where the assets are insufficient to pay the state unemployment and federal social security taxes in full, it will be seen that the amount payable to the state can not be determined until the credit allowable on the federal tax is known and the said credit can not be determined until the amount payable to the state is settled. In view of the variation of these two factors in relation to each other, the United States submits the standard algebraic formula for solving quadratic equations as a method of determining the distribution percentage. Using the symbol A for the amount of the state's claim for unemployment insurance, i. e., $3,305.82; the symbol B for the total of all other taxes, i. e., $9,310.48; the symbol T for the total assets to be distributed, i. e., $3,053.20; and the symbol X for the percentage of distribution to be determined, it is found that the equation $X[(A\&B)-AX]=T$ reduces to $AX^2-(A\&B)X+T=0$. Using the quadratic formula

$$X=\frac{-b\pm\sqrt{b^2-4ac}}{2a}$$

and substituting symbols from the equation previously stated, the equation becomes

$$X=\frac{(A\&B)\pm\sqrt{(A\&B)^2-4AT}}{2A}$$

Upon substituting the known numerical equivalents in the equation and resolving it, the distribution percentage is found to be 25.967%. $858.42 will therefore be available on the state unemployment insurance claim and that amount will be credited against the social security tax claim reducing the latter to $2,542.07. The amounts payable on all claims will then be computed as follows:

Social Security Taxes	$660.10
Other federal taxes	828.14
Unemployment Insurance Taxes	858.42
Other State Taxes	706.53
	3,053.19

The state asserts that this method of computation is unsatisfactory for the reason that it is not applicable to cases wherein the assets are more than sufficient to pay the tax claims in full. It is difficult for the court to believe that in such a case an issue would arise which would require the use

of a formula for determining the distribution, and it seems sufficient to observe that the suggested formula is designed for cases such as that in hand, wherein the assets are insufficient to pay all tax claims in full.

The state further contends that the 90% credit allowed by Section 902 is not to be taken against the amount of Federal tax levied, but against the amount paid to the Federal government. The state submits an arithmetic computation whereby an initial distribution is set up based upon the ratio of each claim to the total amount of all claims. As against the amount set up for payment of social security taxes, credit of 90% is deducted and the amount of such credit distributed as in the first instance. This process is repeated until the credit available reaches the vanishing point. Under this computation the distribution would be as follows:

Social Security	$108.67
Other Federal Taxes	1,018.99
Unemployment Insurance	1,056.09
Other State Taxes	869.45
	3,053.20

The difference between the amounts payable to the state under its own computation and that of the United States is comparatively small, but it is urged that numerous other cases will involve the same question and that a rule should now be established upon which future computation may be made.

16 Section 902 of the Social Security Act, as amended, is clear and unambiguous. It must be assumed to correctly state the intent of the legislature and is not to be construed in derogation of its clear meaning. It is provided that "against the tax imposed by Section 901 * * * the taxpayer shall be allowed credit for the amount of contributions * * * paid by him into an unemployment fund under a state law * * *." However, the "total credit allowed against the tax imposed shall not exceed 90 per centum of such tax." Under the statute it is only when the payments into a state unemployment fund exceed 90% of the federal tax that any question of limitation of credit arises. The federal computation recognizes this rule by giving full credit for the proposed distribution on unemployment insurance. The state would apply the 90% credit against the amount paid to the federal government. The error in such computation is that the state would apply the credit against payments on the tax rather than against the tax itself. While it may seem unequitable to require a larger payment than would be required if the estate were

larger, the statute brings about such a result. The intent of the legislature was to compel prompt and full payment of unemployment insurance payments. If this be inequitable the change must come through amendment of the statute, not by judicial interpretation contrary to the clear meaning of the legislation.

Some question has been raised as to whether contributions under the State Unemployment Act are "taxes." The parties seem now agreed that they are. Some confusion is created by the language of Section 522 sub. 6 of the Labor Law (State Unemployment Fund) and there are certain decisions holding that such
17 contributions are not "taxes": In re Fidelity Fuel Co. (E. D. Pa. 1940); in re Mosby Coal & Mining Co., 24 F. Supp. 1022; In re William Akers, Jr. Co., 31 F. Supp. 900; State of Missouri v. Earhart, 111 F. (2d) 992; Certain of these construed state statutes differing in language from the New York Act. This, however, will make no difference in our view of the application of these cases. The contributions come within the meaning of the word "taxes" as that word has many times been construed. "A tax is defined to be 'a contribution imposed by government on individuals for the service of the state.'" Morgan v. Louisiana, 118 U. S. 455. "The character of a tax is well known. It is a charge or burden laid upon persons or property for public purposes; a forced contribution authoritatively imposed." Trevander v. Ruysdael, 299 F. 753. In re Standard Composition Co., 23 F. Supp. 391; Matter of Otto F. Lange Co., 159 F. 586. Numerous authorities have held that these contributions are in the nature of a tax. Chamberlin, Inc. v. Andrews, 271 N. Y. 1; aff'd 299 U. S. 515; Carmichael v. Southern Coal & Coke Co., 301 U. S. 495; In re 67 Wall St. Restaurant Co., 23 F. Supp. 672; In re Oshkosh Foundry Co., 28 F. Supp. 412; In re Mytinger, 31 F. Supp. 977. The question of whether this state statute imposes a tax is a federal question. New Jersey v. Anderson, 203 U. S. 483; In re Mid America Co., 31 F. Supp. 601; and other cases last above cited. Peculiarly is this so under the Social Security Act.

In a supplemental brief, counsel for the State for the first time urged that the claim of the United States for taxes under Title VIII of the Social Security Act as representing the tax on employees is not entitled to priority under Section 64 of the Bankruptcy Act.

This relates to one-half of the tax imposed under Section
18 801 of Title VIII. This contention cannot be sustained.

The tax is imposed on the employer. Section 802 (a) reads: "Every employer * * * hereby made liable for the payment of the tax." Gulf Oil Co. v. Grady (In re Conklin), 42 A. B. R.

(N. S.) 142 (2d C.), cited by the state is not in point. That case construed the New York tax law Article 12A, Section 228 et seq., which "makes the distributor, not the purchaser, the taxpayer, * * *."

The balance of the moneys in the hands of the trustee is directed to be distributed as follows:

State's claim of $3,305.92 for unemployment compensation contributions	$858.42
Federal claim for Title IX taxes giving effect to credit	660.10
All other State taxes	706.53
All other Federal tax claims	828.14
Total	3,053.19

July 5, 1940.

JOHN KNIGHT,
United States District Judge.

19 In United States District Court

[Title omitted.]

Assignment of Errors

The State of New York, a priority creditor of the above bankrupt, in connection with its appeal herein, sets forth that in the order of the United States District Court for the Western District of New York, dated July 15, 1940, manifest errors were committed to the prejudice of said creditor, the State of New York, to wit:

First. The Court erred in ordering that the claim of the United States for taxes under Title IX of the Social Security Act for the year 1937, filed in the amount of $3,400.49, be paid in the amount of $660.10 from the remaining assets in the bankrupt estate, and failed to direct that the aforesaid claim be reduced by the amount of unpaid taxes due under the New York State Unemployment Insurance Law for the year 1937, but not to exceed 90% of
20 the tax imposed under Title IX of the Social Security Act, and failed to allow as a credit against the taxes imposed under Title IX of the Social Security Act for the year 1937 the amount payable to the State of New York for contributions due under the New York State Unemployment Insurance Law for the year 1937.

Second. The Court erred in ordering that the claims of the United States for taxes under Sections 801 and 804 of Title VIII of the Social Security Act and 1937 Capital Stock tax, filed in the

aggregate amount of $3,189.19, be paid in the amount of $828.14 from the remaining assets in the bankrupt estate, and failed to direct that the claim of the United States for taxes assessed against employees of the bankrupt under Section 801 of Title VIII of the Social Security Act for the year 1937 be disallowed as a priority tax claim against the bankrupt estate, and that said claim be allowed only as a general claim representing a debt due from the bankrupt.

Third. The Court erred in its failure to find and determine that 90% of the claim of the United States for unpaid taxes under Title IX of the Social Security Act for the year 1937, constituted a penalty under the Bankruptcy Act and, therefore, was not allowable as a claim against the bankrupt estate.

Fourth. The Court erred in ordering distribution of the assets of the bankrupt estate herein, upon the priority tax claims filed therein in accordance with an algebraic formula, to wit:

$$X = \frac{A+B-\sqrt{(A+B)^2-4AT}}{2A}$$

21 which, in effect, constituted an erroneous interpretation of Section 902 (a) (3) of the Social Security Act, enacted August 10, 1939, as permitting the bankrupt estate to take a credit against the tax imposed by Title IX of the Social Security Act of only that portion of state unemployment insurance taxes that is actually paid upon distribution into an unemployment fund under a state law, and erroneously failed to interpret the Social Security Act as amended, as providing that insolvent estates pending during the fifty-nine-day period subsequent to August 10, 1939, are entitled to take a credit against the tax imposed under Title IX of the Social Security Act of the amount of taxes imposed under state unemployment insurance laws, but not to exceed 90% of the tax imposed under Title IX.

Fifth. The Court erred in failing to find and direct the disallowance of 90% of the United States claim for taxes under Title IX of the Social Security Act for the year 1937 on the ground that if such tax were allowed it would result in the collection of an erroneous and illegal tax from a bankrupt estate contrary to the provisions of the Bankruptcy Act.

Wherefore, the State of New York, a priority creditor of the above bankrupt, prays that for the errors aforesaid the order of

the District Court for the Western District of New York, dated July 15, 1940, ordering that distribution be made as follows:

United States of America, claim for Title IX, Social Security taxes	$660.10
United States of America, for all other tax claims filed in said proceeding	828.14
State of New York on its claim for unemployment compensation contributions	858.42
State of New York on all other tax claims	706.53

be reversed.

Dated, Albany, N. Y., August —, 1940.

JOHN J. BENNETT, JR.,
Attorney General,
Attorney for the State of New York, Appellant,
Office & P. O. Address, Capitol, Albany, N. Y.

In United States District Court.

Stipulation Designating Contents of Record

August 16, 1940

Whereas, in the above-entitled proceeding the appellant, State of New York, did on the 31st day of July 1940, file with the Clerk of the District Court for the Western District of New York, Notice of Appeal, dated July 21, 1940, from the resettled order of Honorable John Knight, District Court Judge for the Western District of New York, made on July 15, 1940, and entered in the office of the Clerk of that Court upon said day.

Now, therefore, it is hereby stipulated that the record to be certified to this Court by the Clerk of the United States District Court for the Western District of New York on said appeal shall consist of the following:

1. Statement under Rule XIII of the United States Circuit Court of Appeals for the Second Circuit.

23 2. Notice of Appeal to the Circuit Court of Appeals for the Second Circuit, dated July 21, 1940.

3. Petition of trustee subscribed May 3, 1939.

4. Stipulation discontinuing appeal, dated February 1, 1940.

5. Order of Honorable Learned Hand, Chief Judge of the United States Circuit Court for the Second Circuit, dated February 7, 1940.

6. Opinion of Honorable John Knight, dated July 5, 1940.
7. Order of Honorable John Knight, dated July 15, 1940.
8. Assignment of Errors.
9. Stipulation designating record.
10. Stipulation of true transcript.
11. Clerk's Certificate.

Dated, August 16, 1940.

JOHN J. BENNETT, JR.,
Attorney General,
Attorney for the State of New York, Appellant.
GEORGE L. GROBE,
Attorney for the United States, Appellee.

In United States District Court

Stipulation of True Transcript

August 16, 1940

It is hereby stipulated and agreed that the foregoing is a
24 true transcript of the record of said District Court in the above-entitled matter as agreed upon by the parties.

Dated: August 16, 1940.

JOHN J. BENNETT, JR.,
Attorney General,
Attorney for the State of New York, Appellant.
GEORGE L. GROBE,
Attorney for the United States, Appellee.

[Clerk's certificates to foregoing transcript omitted in printing.]

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 127. October Term, 1940

Argued February 11, 1941.—Decided March 17, 1941

In the matter of INDEPENDENT AUTOMOBILE FORWARDING CORPORATION, BANKRUPT

STATE OF NEW YORK, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

Appeal from an order of the District Court for the Western District of New York granting priority to a claim of the United States against the estate of a bankrupt for taxes for the year 1937 assessed against the bankrupt under Title VIII and Title IX of the Social Security Act and also for taxes for the same year assessed against employees of the bankrupt under Title VIII of said Act. Reversed.

Before SWAN, AUGUSTUS N. HAND and CHASE, Circuit Judges.

John J. Bennett, Jr., Attorney General; Attorney for Appellant; Henry Epstein, Solicitor General; W. Gerard Ryan, Francis R. Curran, Asst. Attorneys General, of Counsel.

Samuel O. Clark, Jr., Asst. Attorney General; J. Louis Monarch, Thomas G. Carney, Sp. Assts. to the Attorney General; George L. Grobe, U. S. Attorney; Joseph J. Doran, Asst. U. S. Attorney, for Appellee.

CHASE, Circuit Judge: The Independent Automobile Forwarding Corporation, an employer of labor to whom and to whose employees the provisions of the Federal Social Security Act (c. 531, 49 Stat. 639) were applicable, was adjudicated a bankrupt in the District Court for the Western District of New York on April 26, 1938. The liquidation of its property in the bankruptcy proceedings brought into the hands of the trustee assets insufficient to pay in full the claims filed and allowed priority under Sec. 64 (a) (4) of the Bankruptcy Act. The trustee filed his petition for instructions governing the payment of such

priority claims and an order thereon was made on June 23, 1939, from which an appeal was taken to this court. Part of the claims involved were for taxes due the State of New York and part were for taxes due the United States, including some social-security taxes, and the amount of a credit allowable on the latter was changed by an amendment to the statute that became effective August 10, 1939. In accordance with a stipulation of the parties, an order was entered discontinuing that appeal without costs and remanding the case to the district court for a resettlement of its order which would give effect to the amendment. The order was resettled in a way that granted priority to all the taxes claimed by the federal government and by the state and fixed the percentage payable thereon after allowing a credit on the social security taxes to the extent payments were to be made the State of New York on its claim for taxes which were to be contributions to its unemployment fund. This appeal is from the order so made.

The only claimants who will share in the distribution are the State of New York and the United States whose claims are for taxes for the year 1937 and as their claims, regardless of any issues on this appeal, exceed the amount available for distribution there must, in any event, be a *pro rata* distribution. That is not disputed but what part of the amount due the government for social security taxes should be given priority is in dispute as well as the amount of the allowable credit. There is no controversy as to the amount due the State of New York or that its claim is entitled to priority. Nor is there any dispute but that the part of the government's claim which does not arise under the Social Security Act is also entitled to priority.

Turning now to the points in dispute, the first question is whether all taxes assessed under Title VIII and Title IX of the Social Security Act are to be granted priority under Sec. 64 (a) (4) of the Act as taxes owed by the bankrupt. Those imposed under Title IX and under Sec. 804 of Title VIII are clearly taxes assessed against the employer and so against the bankrupt. The right to priority for so much as may be the correct amount of such taxes is clear but that amount, being in controversy in respect to the Title IX taxes, will later be considered separately herein. That leaves in the first problem only the nature of the liability of the bankrupt under the Social Security Act for taxes imposed under Title VIII; Sec. 801.

Sec. 801 of Title VIII, effective in 1937, provided in so far as presently material that, "In addition to other taxes, there shall be levied, collected and paid upon the income of every individual a tax equal to the following percentage of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date; * * *." And in Sec. 802 (a) of the same Title it was provided that, "The tax imposed by section 801 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer."

This part of the Social Security Act laid a tax upon the employees of this bankrupt measured by a percentage of their wages and not a tax upon the bankrupt. It was taxed to a like extent under Sec. 804 of Title VIII and the two taxes put the burden of social betterment upon both the employer and the employees. As to that part of these taxes which were thus imposed upon the employees the employer was, indeed, made a compulsory tax collector and made liable for the payment of such tax. The employer, however, was liable only as an agent bound to pay whether its duty to collect was performed or not. Such liability for a debt, instead of for taxes due and owing the government, does not form the basis of a claim entitled to priority under Sec. 64 (a) (4). Gulf Oil Corp. v. Grady, 110 F. (2d) 178 (C. C. A. 2); The City of New York v. Feiring, Trustee, — F. (2d) — (C. C. A. 2) decided March —, 1941; In re General Merchandise Corporation of America, 32 F. Supp. 805. Accordingly the taxes assessed under Sec. 801 of Title VIII of the Social Security Act were erroneously allowed as a prior claim. Sec. 607 of the Revenue Act of 1934 providing that whenever any person is required to collect or withhold any tax from another person and pay it over to the United States, the tax so collected or withheld shall be held as a special trust for the United States has no application since there is no proof that any part of the government's claim is for such taxes actually collected or withheld. Even if they had been, only what could be traced could have constituted a trust fund. In re Frank, 25 F. Supp. 1005.

The remaining question involves the meaning of the credit provisions of Sec. 902 (a) of the Social Security Act as amended Aug. 10, 1939. Before the amendment it provided that: "The taxpayer may credit against the tax imposed by Sec. 901 the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a state law. The total credit allowed a taxpayer under this section for all contributions paid into unemployment funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only for contributions made under laws of States certified for the taxable year as provided in section 903."

As the bankrupt made no contributions to any such state fund, there would have been no allowable credit but for the amendment of Aug. 10, 1939. That changed the time as of which credit should be allowed and in the respect here material provided that the credit should be given, "without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction." This provision being applicable to this bankrupt taxpayer, the amount to be paid into the state unemployment fund is a factor to be given effect in determining the amount due on the government's claim. And as the amount so to be paid into the state fund is a tax for which the state has filed its claim in this proceeding the amounts due both the state and the federal governments are variables dependent upon each other since the assets are insufficient to pay both in full. The difficulty just mentioned, however, does not affect the construction of the credit statute and that will be discussed first.

The state contends that the credit should be 90% of the taxes assessable under Title IX, although less than that will actually be paid into the state unemployment fund, leaving the allowable claim only 10% of the taxes assessed. The reasoning in support of that position is that Congress never intended the government to collect as a tax for its use more than 10% of the amount assessable and provided for the credit both to induce states to create unemployment funds (Carmichael v. Southern Coal and Coke Co., 301 U. S. 495, 525-6; Steward Machine Co. v. Davis, 301 U. S. 548,

585) and to persuade employers to make contributions promptly to such funds. From which it is argued that a claim for more than 10% of the amount assessable is as to the excess a claim for a penalty not allowable in bankruptcy by virtue of Sec. 57 (j) of the Bankruptcy Act.

Congress made it clear in the amendment of 1939, Sec. 902 (i); 53 Stat. 1399 that it did not intend to impose a penalty but if one were actually imposed calling it a tax would not change its character. United States v. Constantine, 287 U. S. 287, 294; United States v. La Franca, 282 U. S. 568, 572.

We think the position of the appellant is untenable for the following reasons:

The tax is imposed by Sec. 901 of Title IX (49 Stat. 639) in unequivocal language as an excise tax upon every employer as defined in Sec. 907 measured by stated percentages for named calendar years of the total wages payable by him with respect to employment during such calendar years. The amount of the tax as a tax is thus fixed and to be translated into terms of money by computation when the facts are known. This tax is not affected by Sec. 902 providing for a credit against the tax under certain conditions. If the conditions are fulfilled the taxpayer need not pay in full but if they are not whatever may be due under the provisions of Sec. 901 is all for taxes and none the less so because the taxpayer is given an opportunity to cut down the amount due by making contributions he can use as a credit on his tax liability. That Sec. 902 is not coercive was held in Steward Machine Co. v. Davis and Carmichael v. Southern Coal and Coke Co., both supra. That being so, there is no sound basis for making any distinction between the part of the tax imposed by Sec. 901 which might be adjusted by a credit allowable under Sec. 902 and that which might not. The tax is indivisible and no part is a penalty for not fulfilling the conditions of Sec. 902. The taxpayer is but accorded a right to claim a credit available in lieu of payment *pro tanto* upon compliance with conditions named without requiring him to meet the conditions and without affecting the amount assessable as a tax.

It follows that the language of Sec. 902 controls in determining the amount of the claim under Sec. 901 which is allowable against the bankrupt estate. The credit being limited to what is contributed to the state fund, which will be less than 90% of the tax, the amount of the claim allowable is the difference between the amount assessable and the amount to be treated

as contributed to the state fund. The mutual dependence of these amounts, due to the fact that payments cannot be made in full to either claimant, requires for their determination the use of mathematics adequate to give effect to the fact that they vary with each other.

The government urged the use of an algebraic formula by which the problem was put into a quadratic equation which when solved showed that payment to the claimants of 26.97% of the allowable part of their claims would divide the entire available fund pro rata between them. The use of that will now give the correct amount payable to each claimant when the tax assessed under Sec. 801 Title VIII is disregarded in the computation because allowable only as a general claim. The state insists that no distinction should be made between the present situation and one where the assets are sufficient to pay completely. That is obviously erroneous and the more simple mathematical method of computation it advocates will not suffice here since it will give the correct result only where the amounts are not mutually dependent variables.

Because the original appeal was allowed to be withdrawn in accordance with the stipulation to resettle the order by giving effect to the amendment of Aug. 10, 1939, it has been argued that the question whether taxes due the government under Sec. 801 of Title VIII are entitled to priority is no longer open and that we are bound to treat that part of the government's claim as a prior one because it was so held below in the order from which the first appeal was taken. The short answer is that that order never was considered on its merits in this court and never became final. On the remand the court was to determine how the fund available for distribution to the only two claimants who could share should be divided between them. That necessarily involved the question of priority in all its aspects and left it an open issue.

Order reversed and cause remanded for a determination of the amounts allowable on the claims of each of the claimants in accordance with the above.

United States Circuit Court of Appeals, Second Circuit

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States

Courthouse in the City of New York, on the 12th day of April, one thousand nine hundred and forty-one.

Present: Hon. THOMAS W. SWAN, Hon. AUGUSTUS N. HAND, Hon. HARRIE B. CHASE, Circuit Judges.

In the Matter of INDEPENDENT AUTOMOBILE FORWARDING CORP., BANKRUPT, STATE OF NEW YORK, APPELLANT

Appeal from the District Court of the United States for the Western District of New York.

This cause came on to be heard on the transcript of record from the District Court of the United States for the Western District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and cause remanded for further proceedings in accordance with the opinion of this Court.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

D. E. ROBERTS, *Clerk.*

By A. M. BELL, *Deputy Clerk.*

[Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed April 12, 1941. D. E. Roberts, Clerk.]

UNITED STATES OF AMERICA,

Southern District of New York.

I, D. E. Roberts, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 34, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of In the Matter of Independent Automobile Forwarding Corp., Bankrupt, State of New York, Appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this second day of June, in the year of our Lord one thousand nine hundred and forty-one, and of the Independence of the said United States the one hundred and sixty-fifth.

[SEAL] D. E. ROBERTS, *Clerk.*

U. S. GOVERNMENT PRINTING OFFICE: 1941

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Supreme Court of the United States

No. 238, October Term, 1941

THE UNITED STATES OF AMERICA, PETITIONER

vs.

STATE OF NEW YORK

Order allowing certiorari

Filed October 13, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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Supreme Court of the United States

No. 251, October Term, 1941

STATE OF NEW YORK, PETITIONER

vs.

THE UNITED STATES OF AMERICA

Order allowing certiorari

Filed October 13, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File Nos. 45566, 45579. U. S. Circuit Court of Appeals, Second Circuit. Term No. 238. The United States of America, Petitioner vs. State of New York. Enter Henry Epstein. Term No. 251. State of New York, Petitioner vs. The United States of America. Petitions for writs of certiorari and exhibit thereto. Filed July 5, 1941, July 9, 1941. Term No. 238 O. T. 1941, 251 O. T. 1941.

U. S. GOVERNMENT PRINTING OFFICE: 1941

No. 238

In the Supreme Court of the United States

OCTOBER TERM, 1941

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UNITED STATES OF AMERICA, PETITIONER

v.

STATE OF NEW YORK

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above cause on April 12, 1941.

OPINIONS BELOW

The second opinion of the District Court for the Western District of New York (R. 13–18) is unreported. The first opinion of that court is reported in 28 F. Supp. 428. The opinion of the Circuit Court of Appeals (R. 25–30) is reported in 118 F. (2d) 537.

JURISDICTION

The judgment of the court below was entered April 12, 1941 (R. 31). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the liability of an employer under Section 802 of the Social Security Act to pay the tax levied upon the income of an employee under Section 801 of that Act is a tax liability entitled to priority of payment in bankruptcy within the meaning of Section 64 (a) (4) of the Bankruptcy Act.

STATUTES INVOLVED

The applicable statutes are set forth in the Appendix, *infra*, pp. 7–8.

STATEMENT

The Independent Automobile Forwarding Corporation was adjudicated a bankrupt in the District Court for the Western District of New York on April 26, 1938 (R. 1). The liquidation of the property in the bankruptcy proceedings brought into the hands of the trustee assets of $3,053.20, which were insufficient to pay in full the claims filed and allowed priority under Section 64 of the Bankruptcy Act, *infra* (R. 5, 7–8, 13). The trustee accordingly filed a petition requesting directions from the court as to the order

of priority of the various priority claims (R. 6–9). Priority claims of the United States and of the State of New York are so large as to absorb the entire amount remaining in the hands of the trustee, irrespective of the outcome of this litigation (R. 13); accordingly, they are the only parties in interest in the proceeding.

Among the claims of the United States is one for taxes under Title VIII of the Social Security Act. The State of New York contends that this claim is not entitled to priority under Section 64 (a) (4) of the Bankruptcy Act as a claim for taxes, on the ground that Title VIII imposes a tax on employees rather than on the employer, and that the liability imposed upon the employer to deduct the amount of the tax from the wages of the employees and to pay the tax is a debt rather than a tax liability.

The District Court held that the claim is entitled to priority as a tax claim (R. 17–18) and entered an appropriate order of distribution (R. 4–6). The court below reversed, holding that the claim is not entitled to priority as a tax claim (R. 27).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In refusing to allow the claim of the United States for taxes levied under Title VIII of the Social Security Act as a claim for taxes legally

due and owing by the bankrupt to the United States within the meaning of Section 64 (a) (4) of the Bankruptcy Act.

2. In reversing the judgment of the District Court for the Western District of New York granting priority in payment of the claim of the United States for taxes under Title VIII of the Social Security Act.

ARGUMENT

1. The decision below is in probable conflict with the decision of this Court in *City of New York* v. *Feiring*, No. 863, October Term, 1940, decided May 26, 1941. The conflict is emphasized by the fact that the court below relied as authority for its ruling in this case (R. 27) upon its own earlier decision in the *Feiring* case (118 F. (2d) 329) which this Court subsequently reversed.

In the *Feiring* case, this Court held that a claim for the New York City sales tax against a bankrupt vendor of personal property is entitled to priority under Section 64 (a) (4) of the Bankruptcy Act. The tax statute there involved, as the opinion points out, imposed a tax upon receipts from retail sales of tangible personal property and required the seller to charge the buyer with the amount of the tax separately from the sales price, and to collect the tax from him. The statute further required the seller to file a return

with the City Comptroller, showing his receipts and the tax payable thereon; at the time of filing the return the seller was required to pay the Comptroller the amount of tax due. This Court held that the liability of the seller was a tax liability, despite the fact that the statute enabled him to shift the tax burden to the purchaser and made the purchaser liable as a taxpayer. The opinion states that the liability of the vendor is a "pecuniary burden * * * laid upon the * * * seller for the support of government, and without his consent"; it concludes that such a pecuniary burden "has all the characteristics of a tax entitled to priority of payment in bankruptcy within the meaning of § 64 of the Bankruptcy Act." See also *New Jersey* v. *Anderson*, 203 U. S. 483, 491.

The burden imposed upon employers by Title VIII of the Social Security Act bears a close analogy to the burden imposed upon vendors by the New York City sales tax. The employer is required by Section 802 (a) of the Social Security Act, *infra*, p. 7, to collect the tax from the employees, just as the vendor in New York City is required to collect the tax from the purchasers by billing them separately for the amount of the tax. But the employer, like the vendor, is made liable for the payment of the tax himself, irrespective of whether he has collected it from his employees. This liability, in the words of this

Court's opinion in the *Feiring* case, quoted above, is a "pecuniary burden * * * laid upon the * * * [employer] for the support of government, and without his consent"; under the ruling in the *Feiring* case, such a liability is a tax liability within the meaning of Section 64 (a) (4) of the Bankruptcy Act.

2. The question presented in this case is of substantial fiscal and administrative importance. We are advised by the Bureau of Internal Revenue that there are probably more than 1,000 pending bankruptcy cases which involve claims against a bankrupt employer for taxes under Title VIII of the Social Security Act. In view of this circumstance, and of the fact that the problem will constantly recur, an authoritative decision by this Court is desirable.

CONCLUSION

It is therefore respectively submitted that this petition for a writ of certiorari should be granted.

CHARLES FAHY,
Acting Solicitor General.

JULY 1941.

APPENDIX

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840:

> SEC. 64. *Debts which have priority.*—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * *
> (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: * * *

Social Security Act, c. 531, 49 Stat. 620, Title VIII:

> SECTION 801. In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:
>
> * * * * *
>
> SEC. 802. (a) The tax imposed by section 801 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer.
>
> * * * * *

SEC. 807. (c) All provisions of law * * * applicable with respect to any tax * * * and the provisions of section 607 of the Revenue Act of 1934, shall, insofar as applicable and not inconsistent with the provisions of this title, be applicable with respect to the taxes imposed by this title.

* * * * *

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 607. ENFORCEMENT OF LIABILITY FOR TAXES COLLECTED.

Whenever any person is required to collect or withhold any internal-revenue tax from any other person and to pay such tax over to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose. (U. S. C., Title 26, Sec. 1551.)

U. S. GOVERNMENT PRINTING OFFICE: 1941

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OPINIONS BELOW

The second opinion of the District Court for the Western District of New York (R. 7–11) is unreported; its first opinion is reported in 28 F. Supp. 428. The opinion of the Circuit Court of Appeals (R. 15–20) is reported in 118 F. (2d) 537.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 12, 1941 (R. 21). The petition of the United States for a writ of certiorari, No. 238, was filed on July 5, 1941. The petition of the State of New York for a writ of certiorari, No. 251, was filed on July 9, 1941. Both were granted on October 13, 1941. The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

No. 238

1. Whether the liability of an employer under Section 802 of the Social Security Act to pay the tax levied upon the income of an employee under Section 801 of that Act is a liability for "taxes" and is therefore entitled to priority of payment in bankruptcy within the meaning of Section 64 (a) (4) of the Bankruptcy Act.

No. 251

2. Section 901 of the Social Security Act imposes a tax upon employers and Section 902 permits a credit against that tax (not exceeding 90% thereof) on account of contributions made by the employer to state unemployment compensation funds. Where the assets of a bankrupt employer are

insufficient to meet the Federal and state claims in full, how shall the assets be distributed?

3. Whether any part of the tax imposed by Section 901 of the Social Security Act is a penalty not provable in bankruptcy within the meaning of Section 57 (j) of the Bankruptcy Act.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 27–32.

STATEMENT

The Independent Automobile Forwarding Corporation was adjudicated a bankrupt in the District Court for the Western District of New York on April 26, 1938 (R. 1). The liquidation of the property in the bankruptcy proceeding brought into the hands of the trustee assets of $3,053.20, which are insufficient to pay in full the claims filed and allowed priority under Section 64 of the Bankruptcy Act (R. 5, 7–8).[1] The trustee accordingly filed a petition requesting instructions (R. 4–5). Priority claims of the United States and the State of New York are so large as to absorb the entire amount remaining in the hands of the

[1] The statement under Rule 13 (R. 1) indicates that the claims of the United States aggregate $7,344.11, whereas the opinion and order of the District Court (R. 5, 7–8) show that such claims total only $6,589.68. We accept the latter figure as correct.

trustee, irrespective of the outcome of this litigation (R. 7).

An appeal taken by the State of New York from an order of the District Court entered June 23, 1939, was, upon stipulation of the parties, discontinued by order of the Circuit Court of Appeals entered February 7, 1940, and the case was remanded to the District Court (R. 6–7). As shown by the stipulation and order, the purpose of the remand was to permit the District Court to resettle its order in accordance with the intervening Social Security Act Amendments of 1939, effective August 10, 1939. The judgment of the Circuit Court of Appeals entered April 12, 1941 (R. 21), which this Court has consented to review, relates to the order of the District Court of July 15, 1940 (R. 3–4), after the remand.

Among the claims of the United States is one for taxes under Sections 801 and 802 (Title VIII) of the Social Security Act (R. 1). The State of New York contends that this claim is not entitled to priority under Section 64 (a) (4) of the Bankruptcy Act as a claim for taxes, on the ground that Title VIII imposes a tax on employees rather than on the employer, and that the liability imposed upon the employer to deduct the amount of the tax from the wages of the employees and to pay the tax does not constitute a liability for taxes (R. 10). The District Court held that this claim is entitled to priority as a tax claim (R. 10–

11), and entered an appropriate order of distribution (R. 3–4). The Circuit Court of Appeals reversed, holding that this claim is not entitled to priority as a tax claim (R. 16–17).

Among the remaining claims are a claim of the United States under Section 901 (Title IX) of the Social Security Act and a claim of the State of New York for unemployment-compensation contributions under a law of that state. The remaining issues before this Court relate to the amount in which the Title IX claim of the United States may be allowed for the purpose of sharing in the distribution of the available assets, in view of the credit provisions contained in Section 902 of the Social Security Act, as amended. Both the District Court (R. 7–10) and the Circuit Court of Appeals (R. 18–20) held in accordance with the contentions of the United States with respect to this claim, which will be set forth at length in the Argument, Points II and III, *infra*.

SPECIFICATION OF ERRORS TO BE URGED IN NO. 238

The Circuit Court of Appeals erred:

1. In refusing to allow the claim of the United States for taxes levied under Title VIII of the Social Security Act as a claim for taxes legally due and owing by the bankrupt to the United States within the meaning of Section 64 (a) (4) of the Bankruptcy Act.

2. In reversing the judgment of the District Court for the Western District of New York grant-

ing priority in payment to the claim of the United States for taxes under Title VIII of the Social Security Act.

SUMMARY OF ARGUMENT

I

Section 801 of the Social Security Act requires that there shall be levied, collected and paid upon the income of every individual a tax equal to specified percentages of his wages. Section 802 (a) of that Act requires that the tax imposed by section 801 shall be collected by the employer of the taxpayer by deducting the amount of the tax from his wages and shall be paid to the United States by the employer. The employer is made liable for the payment of the tax irrespective of whether he has collected it from the employees and the Commissioner of Internal Revenue may assess and collect the tax as a tax from the employer. The obligation imposed upon the employer is indistinguishable from the obligation imposed upon the vendor by the New York City sales tax act, which was considered by this Court in *New York* v. *Feiring*, 313 U. S. 283. The decision of this Court in the *Feiring* case is sound and requires the reversal of the Circuit Court of Appeals in its holding that the claim of the United States under Sections 801 and 802 (a) of the Social Security Act is not provable under Section 64 (a) (4) of the Bankruptcy Act.

II

Section 902 of the Social Security Act, as amended, permits a credit to be taken against the tax imposed by Section 901 of that Act for amounts paid into unemployment compensation funds established under state laws. But in order for the credit to be granted, there must be strict compliance with the conditions of the Act. So far as here pertinent, these requirements are (1) that credit shall be allowed only for amounts actually paid into state unemployment compensation funds, and (2) that credit shall be taken against the amount of the tax imposed by Section 901 rather than against the amount of the distribution which may be made by a bankrupt estate with respect to the tax. In formulating a proper method of distributing the assets of a bankrupt employer, a third requirement, arising from Section 64 (a) (4) of the Bankruptcy Act, demands that the claim of the United States for taxes under Section 901 as finally allowed must share *pro rata* with other tax claims. The method of distribution urged by the United States and approved by both courts below fully satisfies these three requirements. The method of distribution urged by the State of New York violates at least two of the three requirements.

III

No part of the claim of the United States under Section 901 of the Social Security Act is for a

penalty. The total tax imposed is related to the burden laid upon the Federal Government by unemployment in the various states, and the amounts actually paid into a state fund in mitigation of the federal obligation are credited against the federal tax. Furthermore, the 1939 amendment to the Social Security Act upon which the state must rely for its claim expressly declares that "No part of the tax imposed by * * * Title IX * * * shall be deemed to be a penalty or forfeiture within the meaning of section 57 (j)" of the Bankruptcy Act.

ARGUMENT

I

THE LIABILITY IMPOSED UPON THE BANKRUPT BY SECTION 802 (A) OF THE SOCIAL SECURITY ACT TO PAY THE TAXES LEVIED UPON THE INCOMES OF ITS EMPLOYEES BY SECTION 801 OF THAT ACT IS A LIABILITY FOR TAXES WITHIN THE MEANING OF SECTION 64 (A) (4) OF THE BANKRUPTCY ACT

Section 801 of the Social Security Act (Appendix, *infra*, p. 27) provides, so far as pertinent here, that "there shall be levied, collected, and paid upon the income of every individual a tax" equal to specified percentages of the wages "received by him after December 31, 1936, with respect to employment." Section 802 (a) provides that the "tax imposed by section 801 shall be collected by the employer of the taxpayer, by de-

ducting the amount of the tax from the wages as and when paid," and that every "employer required so to deduct the tax is hereby made liable for the payment of such tax" (Appendix, *infra*, p. 27). See *Helvering* v. *Davis*, 301 U. S. 619, 634–635. The amount of taxes so imposed by Section 801, and made payable by the bankrupt by Section 802 (a), constitutes a part of the taxes claimed by the United States under Title VIII of the Social Security Act; the balance of that claim, representing taxes imposed under Section 804, is not in dispute.[2] The District Court held (R. 17–18) that the amounts for which the bankrupt was liable under Sections 801 and 802 (a) constituted "taxes" within the meaning of Section 64 (a) (4) of the Bankruptcy Act (Appendix, *infra*, p. 30), and that the claim for these amounts was therefore entitled to priority. The Circuit Court of Appeals reversed on this point (R. 27), holding that the obligation imposed upon the employer was for a "debt" rather than for taxes and did not form the basis of a claim entitled to priority under Section 64 (a) (4).

In reaching the conclusion that the obligation imposed upon the bankrupt by Sections 801 and 802 (a) did not constitute a liability for taxes, the Circuit Court of Appeals relied, in part, upon its own decision in *In re National Studios*, 118 F.

[2] The record on appeal does not indicate the exact amount of taxes claimed under Title VIII or the amount of such taxes here in dispute (Cf. R. 1 with R. 7–8).

(2d) 329. (R. 17.) But that decision was subsequently reversed by this Court, *sub nom., New York* v. *Feiring*, 313 U. S. 283, and we submit that the decision of this Court in the *Feiring* case requires reversal here.

In the *Feiring* case, this Court held that the claim of the City of New York for a city sales tax against a bankrupt vendor of personal property was entitled to priority under Section 64 (a) (4) of the Bankruptcy Act. The taxing statute there involved, as the opinion points out (313 U. S. at pp. 286–287), laid a tax upon receipts from retail sales of tangible personal property in New York City and required the vendor to charge the vendee with the amount of the tax separately from the sales price and to collect the tax from him. The vendee, in turn, was commanded to pay the tax to the vendor for the account of the City of New York. The vendor was required to make periodic returns of his receipts and the taxes payable and to pay the tax to the City Comptroller. In the event that the vendor failed to collect the tax from the vendee, the statute made it the duty of the vendee to file a return and to pay the tax directly to the Comptroller. By Section 8 of the statute, machinery was provided for the collection of the tax from either the vendor or the vendee. The opinion of the Court also referred (p. 287) to the fact that in construing the foregoing provisions the New York Court of Appeals had held that while the Comptroller might proceed to collect the

tax from the vendee if he had not paid it to the vendor, the duty to pay the tax was also laid upon the vendor whether he had in fact collected it and regardless of his ability to collect it from the vendee. From these circumstances, this Court concluded (p. 287):

> The statute thus contains provisions which in its normal operation are calculated to enable the seller to shift the tax burden to the purchaser, * * *. But it is plain that both the vendor and the vendee are made liable for payment of the tax *in invitum* without regard to those provisions by which the seller may shift the incidence of the tax to the buyer and the tax may be summarily collected by distraint of the property of either the seller or the buyer. A pecuniary burden so laid upon the bankrupt seller for the support of government, and without his consent, thus has all the characteristics of a tax entitled to priority of payment in bankruptcy within the meaning of § 64 of the Bankruptcy Act. * * *

It will be seen that the obligation imposed upon employers by Sections 801 and 802 (a) of the Social Security Act is strictly analogous to the burden imposed upon vendors by the New York City sales tax. The employer is required by Section 802 (a) to collect the tax from the employees, just as the vendor in New York City is required to collect the tax from the purchasers by billing them separately for the amount of the tax. The employer, equally with the vendor, is made liable for

the payment of the tax irrespective of whether he has collected it from another.[3] The Commissioner of Internal Revenue may assess the tax against the employer and, as in the case of the New York City vendor, may recover the tax from him by the summary procedures available to the sovereign for the collection of revenue. Sections 806 and 807 (c) of the Social Security Act; Article 505 of Treasury Regulations 91, promulgated under Title VIII of the Social Security Act. (Appendix, *infra*, pp. 27–28, 31.) From this comparison, it seems plain that the obligation imposed upon an employer by Sections 801 and 802 (a) of the Social Security Act, no less than the obligation placed upon the vendor by the New York City sales tax, is a "pecuniary burden * * * laid upon the bankrupt * * * for the support of government, and without his consent" and "thus has all the characteristics of a tax entitled to priority of payment in bankruptcy within the meaning of § 64 of the Bankruptcy Act." 313 U. S. at p. 287.

In reaching a contrary conclusion the Circuit Court of Appeals erred, we submit, in misapplying a distinction which in other circumstances is valid. The court drew a distinction between a taxpayer and a tax collector, holding that the tax as such was laid upon the employees and that the

[3] As the Circuit Court of Appeals correctly pointed out (R. 17), the record does not show that the bankrupt ever deducted the taxes imposed by Section 801 from the wages of its employees.

employer was made merely "a compulsory tax collector * * * liable only as an agent bound to pay" (R. 17). The distinction so drawn between the person upon whom by force of the taxing statute the economic burden of the tax is imposed and the compulsory tax collector, who is required to collect the amount of the tax from such person and pay it over to the governmental authority, appears to be a sound one as applied, for example, to suits for refund of taxes paid. See *Regents of University System of Georgia* v. *Page*, 81 F. (2d) 577, 579, 580, 582, 93 F. (2d) 887, 889 (C. C. A. 5th), affirmed in this respect *sub nom, Allen* v. *Regents*, 304 U. S. 439, 445–449; *Shannopin Country Club* v. *Heiner*, 2 F. (2d) 393 (W. D. Pa.). This is true since the public interest requires that, absent express authorization to the contrary, refund of taxes erroneously paid should be made only to the person upon whom the statute has imposed the burden of the tax. Similarly, the distinction between taxpayer and tax collector may be useful in determining whether a forbidden tax burden is laid upon interstate commerce (*McGoldrick* v. *Berwind-White Co.*, 309 U. S. 33, 43–44) or upon a national bank (*Colorado Bank* v. *Bedford*, 310 U. S. 41, 52–53). But wholly different considerations are involved in applying Section 64 (a) (4) of the Bankruptcy Act. The public interest expressed in that section, manifestly, is the interest in securing for governments, both state and federal, the monies essential for their continu-

ance. When viewed against the background of the Bankruptcy Act, the distinction between taxpayer and tax collector in these circumstances should give way to the controlling fact that the bankrupt is legally liable for payment of amounts imposed as a tax. Long before the *Feiring* case, this Court had brushed aside technical refinements and given a liberal interpretation to the expression "taxes" as used in the Bankruptcy Act. "Generally speaking," this Court had said, "a tax is a pecuniary burden laid upon individuals or property for the purpose of supporting the Government." *New Jersey* v. *Anderson,* 203 U. S. 483, 492; cf. *United States* v. *Updike,* 281 U. S. 489, 494. Both of these cases were referred to by this Court in the *Feiring* opinion.

The decision in *New York* v. *Feiring, supra,* is thus sound in principle and indistinguishable from the instant case. It would clearly seem to require the reversal of the holding of the Circuit Court of Appeals that the liability imposed upon the bankrupt by Section 801 and Section 802 (a) of the Social Security Act is not entitled to priority under Section 64 (a) (4) of the Bankruptcy Act.

II

THE COURTS BELOW PROPERLY APPLIED THE CREDIT PROVISION OF SECTION 902 OF THE SOCIAL SECURITY ACT, AS AMENDED, IN ORDERING A FINAL DISTRIBUTION

The remaining issues in controversy concern the claim of the United States under Section 901 of

Title IX of the Social Security Act. (Appendix, *infra*, p. 28.) We consider, first, the state's contention that the District Court failed to allow a proper credit against this Title IX claim and thereby awarded that claim an excessive share of the available assets. The method of computation applied by the District Court (R. 7–8) was approved by the Circuit Court of Appeals (R. 18–20).

Section 902 of the Social Security Act, both as originally enacted and as amended, allows a credit against the tax imposed by Section 901 of that Act in an amount up to but not exceeding 90% of the federal tax for contributions paid into unemployment compensation funds under state laws. (Appendix, *infra*, pp. 28–29.) But the credit is carefully limited and may be allowed only if the requirements expressly provided by the Social Security Act are satisfied. See *Steward Machine Co.* v. *Davis*, 301 U. S. 548, 574–576, 593–596. The requirements pertinent here are set forth in Section 902. As originally enacted, Section 902 permitted the taxpayer a credit of not exceeding 90% of the federal "tax" for "contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law." As amended by the Social Security Act Amendments of 1939, effective August 10, 1939, Section 902 of the Social Security Act provides:

SEC. 902. (a) Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law—

* * * * *

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

* * * * *

From these provisions, it will be seen that under the original Section 902, as applied to the instant case, no credit whatsoever could be allowed for amounts distributed to the State of New York under its unemployment compensation act, since such payments were not made before January 31, 1938, the date fixed for filing the federal return for the year 1937 (Section 905 (b) of the Social Security Act).[4] It will likewise be noted that by virtue of the 1939 amendment, credit may be allowed, since as applied to this case the *date* of payment into the state fund is no longer a decisive factor. But both as originally enacted and as

[4] The Title IX claim is for wages paid during 1937. See the first opinion of the District Court, 28 F. Supp. 428.

amended, Section 902 requires (1) that the credit shall be allowed against the "tax" imposed by Title IX, and (2) that the credit shall be allowed only for amounts actually "paid" into the state fund. Any proper method of distribution must obviously comply with these two requirements.

A third requirement which must be met stems from the Bankruptcy Act. Under Section 64 (a) (4) of that Act, taxes legally due and owing by the bankrupt to the United States and to the state must share pro rata. *Missouri* v. *Ross*, 299 U. S. 72.

The amount in the hands of the trustee for final distribution on the various tax claims is $3,053.20 (R. 3). The amounts of the various tax claims entitled to priority under Section 64 (a) (4) of the Bankruptcy Act are as follows (R. 7–8):

Claim of the United States under Title IX of the Social Security Act	$3,400.49
Remaining tax claims of the United States	3,189.19
Claims of the State of New York for unemployment compensation contributions	3,305.82
Remaining tax claims of the State of New York	2,720.80

In these circumstances, as will be shown in detail in footnote 6, *infra*, the proper distribution percentage will be found to be 25.967%.[5] Using this

[5] This percentage is computed upon the basis that the claim of the United States under Sections 801 and 802 (a) of the Social Security Act is entitled to priority under Section 64 (a) (4) of the Bankruptcy Act (*supra*, pp. 8–14) and is, therefore, entitled to share pro rata with the other tax claims. If the Court disagrees with our position in Point I in this respect, the percentage figure will, of course, be increased. The method of computation, however, would remain the same.

percentage, $858.42 will be available for payment on the state's claim of $3,305.82 for unemployment compensation contributions. When this dividend is allowed as a credit against the claim of the United States for Title IX taxes, the latter claim is reduced to $2,542.07. Applying the percentage figure to the Title IX claim, as so reduced, $660.10 will be available for payment of it. Again applying the same percentage figure to the remaining claims of the United States and of the state, the amounts of $828.14 and $706.53, respectively, will be found available for the payment of these claims. The total of the four distributions set forth will be found to equal the total available assets of $3,053.19.

The District Court approved this method of distribution and applied the percentage figure we have used (R. 8). The Circuit Court of Appeals approved the method (R. 20) but could not apply the same percentage figure because of its decision on the preliminary question discussed in Point I that the Title VIII taxes were not entitled to priority.

This method of computation, we submit, fully satisfies the three requirements which must be met. (1) The amount of $858.42 is properly allowed as a credit against the Title IX claim because that amount will actually be paid to the state upon its claim for unemployment-compensation contributions (and does not exceed 90% of the federal claim). (2) The amount of $858.42

so allowed as a credit is properly taken against the total amount of the Title IX claim—i. e., against the amount of the "tax imposed by Section 901 of the Social Security Act." (3) All of the tax claims, including the claim under Title IX, as reduced by proper credit, share the assets of the estate in equal proportions. Both mathematically and legally, therefore, the distributions so computed are proper. It follows, likewise, that any system of computation which results in different amounts to be distributed upon the respective claims cannot satisfy the statutory requirements.

While the method of arriving at the applicable percentage of 25.967 is primarily a mathematician's rather than a lawyer's problem, the procedure followed is nevertheless pertinent. Since the amount of the Title IX claim to be finally used as a basis for distribution is dependent upon the amount of the payment to be made upon the claim of the state for unemployment compensation contributions, and since the latter, in turn, is necessarily dependent upon the amount of the Title IX claim to be finally used, the two amounts are variables dependent upon each other. Hence, it is necessary to translate the amounts involved into an equation, which can then be solved by recognized algebraic methods.*

* Let A=amount of State's claim for unemployment compensation contributions ($3,305.82). Let B=total *gross* amount of all other tax claims ($3,400.49 Title IX taxes, plus $3,189.19 other Federal taxes, plus $2,720.80 other state taxes,

It is unnecessary to analyze in detail the alternative formula submitted by the state ~~since~~, for, as we have seen, the method approved by the courts below fully satisfies the statutory requirements. It may be observed, however, that the method offered by the state in fact violates at least two of the three essential requirements. (1) The state

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making a total of $9,310.48). Let T = total assets available for distribution ($3,053.19). Since only a percentage of the claims can be satisfied, let x = percentage. But under Title IX, the amount of the *net* Federal claim will be the tax imposed thereunder ($3,400.49) minus the credit for the amount actually distributed to the state, i. e., minus xA. Accordingly the total *net* amount of all tax claims, exclusive of the state's claim for unemployment compensation contributions, is B − xA. And the total of all the net claims of both the state and the United States is equal to A + B − xA.

Therefore, $T = x(A+B-xA)$,

$$T = x(A+B) - x^2A,$$

$$Ax^2 - (A+B)x + T = O.$$

This is a quadratic equation in the general form, $ax^2+bx+c=0$, which is solved by the recognized formula $x = \frac{-b \pm \sqrt{b^2-4ac}}{2a}$. Applying that formula here, the solution becomes:

$$x = \frac{-[-(A+B)] \pm \sqrt{[-(A+B)]^2 - 4AT}}{2A},$$

$$x = \frac{A+B \pm \sqrt{(A+B)^2 - 4AT}}{2A}$$

As is the case in every quadratic equation there are two solutions depending upon whether the "+" or the "−" is used before the square root. But since the use of the "+" would give a value for x in excess of 100% in the circumstances of this case, it is obvious that the "−" is the only correct alternative that can be used here.

Accordingly, by substituting the known values for A, B, and T, the value of x is found to be 25.967%.

contends that the bankrupt should be credited with 90% of the Title IX claim *regardless* of the amount paid into the state fund. (2) Under the state's formula, credit is taken not against the Title IX claim, but against the *distributions* made upon that claim. Neither as originally enacted nor as amended does Section 902 sanction this method of computing the allowable credit.

We submit, therefore, that the courts below properly applied the credit provisions of Section 902 and that their action in this respect should not be disturbed.

III

NO PART OF THE CLAIM OF THE UNITED STATES UNDER TITLE IX OF THE SOCIAL SECURITY ACT IS A PENALTY WITHIN THE MEANING OF SECTION 57 (J) OF THE BANKRUPTCY ACT

As indicated above, the State of New York contends that a credit in the amount of 90% of the federal claim under Title IX—that is, in the amount of $3,060.44—is allowable against the Title IX claim, whereas under the computation set forth above, the credit against the Title IX claim is limited to $858.42, the amount actually available for distribution on the state's claim for unemployment compensation contributions. From this the state contends that the increase in the amount of the Title IX claim finally used as a basis of distribution which is attributable to the allowance of a credit of $858.42 rather than a credit of $3,060.44 represents a penalty

awarded to the United States. Otherwise expressed, the state contends that the Title IX claim should have been finally allowed for $340.05 (representing 10% of the total claim of $3,400.49) rather than for $2,542.07 (the amount allowed in the computation) and that the difference constitutes a penalty, which can not be allowed under Section 57 (j) of the Bankruptcy Act. Both the District Court (R. 9–10) and the Circuit Court of Appeals (R. 18–20) correctly, we submit, rejected that contention.

Title IX imposes a tax but allows a credit of not to exceed 90% for similar taxes paid to any state. Thus, the portion of the claim in this case in excess of 10% is not an amount which has been added to the tax but is a portion of the tax itself. The state's contention is in essence that the withholding of a credit amounts to the imposition of a penalty. Since the credit is a gratuity which Congress is free to grant or withhold, the state's position is untenable unless the condition attached to the credit converts it into a penalty.

We are not dealing here with an exaction imposed in order to compel compliance with requirements in which the Federal Government has no proper interest. See *Steward Machine Co.* v. *Davis,* 301 U. S. 548, 586–590; cf. *United States* v. *Constantine,* 296 U. S. 287, 295–296. This Court has already pointed out that the total amount of the federal tax imposed by Title IX bears a relationship to the demands upon the Federal Gov-

ernment for unemployment relief in the various states in the absence of provision by the states for unemployment compensation and that the allowance of the credit is a proper recognition that in those states which administer their own systems of unemployment relief the demands upon the Federal Treasury may be *pro tanto* reduced. *Steward Machine Co.* v. *Davis, supra,* pp. 586–590; *Carmichael* v. *Southern Coal Co.,* 301 U. S. 495, 525–526. Although the Court was here referring broadly to the interest of the Federal Government in the establishment of state unemployment compensation systems, its remarks apply equally to a situation, such as the present, where the taxpayer does not in fact discharge his obligations to a state fund. The opinion in the *Steward Machine* case observed (p. 589) that "fulfilment of the home duty will be lightened and encouraged by crediting the taxpayer upon his account with the Treasury of the nation *to the extent that his contributions* under the laws of the locality have simplified or diminished the problem of relief and the probable demand upon the resources of the fisc." [Italics supplied.] This is palpably sound since the drain upon the Federal Treasury will be reduced not by the amount of the state's claim for unemployment compensation contributions but only by the amount actually paid into the state fund. These considerations prove groundless the state's contention that where the taxpayer is bankrupt any amount for which the Title IX claim is

allowed in excess of 10% of that claim constitutes a penalty, regardless of the amounts actually paid into the state fund.

The state will doubtless point out that, using the basis of computation approved by the courts below, the Title IX claim will secure a distribution in the amount of $660.10, whereas, if the estate were solvent and if the state claim were paid in full, the Title IX claim would secure a distribution of only $340.05. This is true since the Title IX claim is reduced only to $2,542.07 after allowance of the credit, while if the estate were solvent and the claim of the State of New York for unemployment-compensation contributions were paid in full, the amount of the Title IX claim would be reduced upon allowance of proper credit to $340.05. But here it is impossible *on any method of computation* for the bankrupt fully to discharge its obligation under the state unemployment-compensation law. So far as the bankrupt is concerned, the cooperative scheme contemplated by the Social Security Act has broken down. Furthermore, while the state's method of computation would result in a somewhat increased distribution to its own unemployment-compensation fund, the aggregate amount received by both federal and state governments under the state's computation would be substantially reduced. Thus, the state would distribute $1,056.09 to its own unemployment-compensation fund and would allow the Federal Government $108.67 on its Title IX claim, a

total of $1,164.76. Under the computation approved by the courts below, the state fund will receive $858.42 and the Title IX claim will receive $660.10, an aggregate of $1,518.52. It is obviously inconsistent with the policy of the Social Security Act that the credit provisions of that Act should be applied in the case of a bankrupt employer to minimize the total amount collected for relief of unemployment.[7] The state's method of computation nevertheless achieves this result.

Section 902 (i) of the 1939 amendments to the Social Security Act has removed any doubt upon the point here in issue, for Congress has expressly provided that no part of the tax imposed by Title IX of the Social Security Act, whether or not the taxpayer is entitled to a credit against such tax, shall be deemed to be a penalty or forfeiture within the meaning of Section 57 (j) of the Bankruptcy Act. (Appendix, *infra*, p. 30.) Even if prior to this amendment any part of the claim under Title IX could properly have been considered a penalty within the meaning of the Bankruptcy Act, the amendment has set the mat-

[7] As this Court pointed out in the *Steward Machine* case, while the amounts collected under Title IX are covered into the Treasury "like internal-revenue collections generally" (301 U. S. at p. 574), the amounts so collected may be taken as a measure of the amount which the Federal Government will be called upon to expend in order to alleviate unemployment (301 U. S. at pp. 588–589). The Federal Government also appropriates sums to the states for the administration of their unemployment compensation laws. Section 301 of the Social Security Act.

ter at rest. There can be no question that the provision referred to is applicable to the instant case; the state, as we have seen, must base its claim for credit upon paragraphs (a) (3) of the same section.[8] Nor does Congress lack constitutional authority to give priority in bankruptcy to what would normally be considered a penalty. Under Section 3466 of the Revised Statutes, this Court has awarded priority to penalties due the United States. *Spokane County* v. *United States*, 279 U. S. 80, 86, 93.

CONCLUSION

For the above reasons, it is submitted that the judgment of the Circuit Court of Appeals should be reversed with respect to the claim of the United States under Sections 801 and 802 (a) of the Social Security Act and should otherwise be affirmed.

Respectfully submitted.

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JANUARY 1942.

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[8] Furthermore, the legislative history of this enactment shows that it was not intended to effect a substantive change in the prior law, but was designed merely to set at rest the question presented in numerous pending cases. S. Rep. No. 734, 76th Cong., 1st Sess., p. 91.

APPENDIX

Social Security Act, c. 531, 49 Stat. 620:

SECTION 801. In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum.

* * * * *

(U. S. C. Supp. V, Title 42, Sec. 1001.)

SEC. 802. (a) The tax imposed by section 801 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

* * * * *

(U. S. C. Supp. V, Title 42, Sec. 1002.)

SEC. 806. If more or less than the correct amount of tax imposed by section 801 or 804 is paid or deducted with respect to any wage payment and the overpayment or underpayment of tax cannot be adjusted under section 802 (b) or 805 the amount of the overpayment shall be refunded and

the amount of the underpayment shall be collected, in such manner and at such times (subject to the statutes of limitations properly applicable thereto) as may be prescribed by regulations made under this title.
(U. S. C. Supp. V, Title 42, Sec. 1006.)

SEC. 807. * * *

* * * * *

(c) All provisions of law, including penalties, applicable with respect to any tax imposed by section 600 or section 800 of the Revenue Act of 1926, and the provisions of section 607 of the Revenue Act of 1934, shall, insofar as applicable and not inconsistent with the provisions of this title, be applicable with respect to the taxes imposed by this title.

* * * * *

(U. S. C. Supp. V, Title 42, Sec. 1007.)

SECTION 901. On and after January 1, 1936, every employer (as defined in section 907) shall pay for each calendar year an excise tax, with respect to having individuals in his employ, equal to the following percentages of the total wages (as defined in section 907) payable by him (regardless of the time of payment) with respect to employment (as defined in section 907) during such calendar year:

(1) With respect to employment during the calendar year 1936 the rate shall be 1 per centum;

(2) With respect to employment during the calendar year 1937 the rate shall be 2 per centum;

(3) With respect to employment after December 31, 1937, the rate shall be 3 per centum.

(U. S. C. Supp. V, Title 42, Sec. 1101.)

SEC. 902. The taxpayer may credit against the tax imposed by section 901 the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law. The total credit allowed to a taxpayer under this section for all contributions paid into unemployment funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only for contributions made under the laws of States certified for the taxable year as provided in section 903.

(U. S. C. Supp. V, Title 42, Sec. 1102.)

Social Security Act Amendments of 1939, c. 666, 53 Stat. 1360, 1399:

SEC. 902. (a) Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law—

* * * * *

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

* * * * *

(i) No part of the tax imposed by the Federal Unemployment Tax Act or by title IX of the Social Security Act, whether or not the taxpayer is entitled to a credit against such tax, shall be deemed to be a penalty or forfeiture within the meaning of section 57j of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, as amended.
(U. S. C. Supp. V, Title 42, Sec. 1102 Note.)

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by Act of June 22, 1938, c. 575, 52 Stat. 840:

SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.—* * *

* * * * * *

(j) Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * * * * *

(U. S. C. Supp. V, Title 11, Sec. 93.)

SEC. 64. DEBTS WHICH HAVE PRIORITY.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any

property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the courts; * * *

* * * * *

(U. S. C. Supp. V, Title 11, Sec. 104.)

Treasury Regulations 91, promulgated under Title VIII of the Social Security Act:

ART. 505. *Assessment of underpayments.*—If any tax is not paid to the collector when due, the Commissioner may, as the circumstances warrant, assess the tax (whether or not the underpayment is otherwise adjustable) or afford the employer opportunity to adjust the underpayment pursuant to article 502 or 503. Unpaid employers' tax or employees' tax may be assessed against the employer. Employees' tax not collected by the employer may also be assessed against the employee. The unpaid amount, together with interest and penalty, if any, will be collected, pursuant to section 3184 of the United States Revised Statutes and other applicable provisions of law, from the person against whom the assessment is made. If any amount of an assessment has been previously reported and paid to the collector as an adjustment or otherwise, the person against whom the assessment is made is privileged to file with the collector a claim for abatement of such amount, together with interest and penalty thereon if included in the assessment. If an employer pays employees' tax pursuant to an

assessment against him without an adjustment having been made pursuant to article 502, reimbursement is a matter to be settled between the employer and the employee. See article 602, relating to interest, and article 603, relating to penalty for failure to pay an assessment after notice and demand. See also article 601, relative to jeopardy assessments.

U. S. GOVERNMENT PRINTING OFFICE: 1943

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 238

THE UNITED STATES OF AMERICA,
Petitioner,

vs.

STATE OF NEW YORK.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

MEMORANDUM FOR THE STATE OF NEW YORK.

JOHN J. BENNETT, JR.,
Attorney General of the State of New York.
HENRY EPSTEIN,
Solicitor General of the State of New York,
Counsel for Respondent.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 238

In the Matter of INDEPENDENT AUTOMOBILE FORWARDING CORPORATION, Bankrupt.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

MEMORANDUM FOR THE STATE OF NEW YORK.

The State of New York does not oppose the petition for a writ of certiorari in this case.

The court below held that the claim of the United States for taxes imposed under the Social Security Act, Title VIII, Section 801, was not entitled to priority under § 64 (a) (4) of the Bankruptcy Act, since such taxes were a debt owing from the bankrupt and were not a tax levied upon

the bankrupt. While it is believed that the conclusion reached below is correct, the State of New York desires that the question be reviewed by this Court. The question presented is important since there are several matters pending in the State of New York involving the identical question.

JOHN J. BENNETT, JR.,
Attorney General of the State of New York.
HENRY EPSTEIN,
Solicitor General of the State of New York.

5th August, 1941.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 238

THE UNITED STATES OF AMERICA,
Petitioner,

vs.

STATE OF NEW YORK.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE STATE OF NEW YORK.

JOHN J. BENNETT, JR.,
Attorney General of the State of New York,
HENRY EPSTEIN,
Solicitor General,
WILLIAM GERARD RYAN,
Assistant Attorney General,
Counsel for Petitioner.

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CITATIONS.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE STATE OF NEW YORK.

Opinions Below.

The second opinion of the District Court for the Western District of New York (R. 13-18) is unreported. The first opinion of that court is reported in 28 F. Supp. 428. The opinion of the Circuit Court of Appeals (R. 25-30) is reported in 118 F. (2d) 537.

Jurisdiction.

The judgment of the court below was entered April 12, 1941 (R. 31). The petition for a writ of certiorari was filed July 5, 1941, and granted October 13, 1941. The jurisdiction of this Court rests upon § 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Summary of Argument.

Section 801 of the Social Security Act imposes a tax upon the income of employees in employment as defined in the Social Security Act. Section 802 (a) which requires the employer of the taxpayer, the employee, to deduct from his wages the amount of the tax, does not make the employer liable for a tax as a taxpayer but rather for a debt as a collecting agent of the United States. A decision of this Court in *City of New York* v. *Feiring*, 313 U. S. 283 is not applicable to the issue here involved since the incidence of the tax imposed by § 801 of the Social Security Act is solely on the employee while the incidence of the tax imposed in the *Feiring* case was on both the vendor and the vendee.

ARGUMENT.

The claim of the United States for taxes imposed upon employees of this bankrupt under Title VIII, § 801 of the Social Security Act, is not entitled to priority under § 64 (a)(4) of the Bankruptcy Act.

Section 801 of the Social Security Act, which was in effect during 1937, provided in part as follows:

> "Sec. 801. In addition to other taxes, there shall be levied, collected and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be one percentum. * * *"

Section 802 (a), as in effect in 1937, provided that:

"The tax imposed by section 801 shall be collected by the employer of the *taxpayer*,[1] by deducting the amount of the tax from the wages as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer."

It is submitted that this is not a tax upon *the bankrupt*, but a tax upon the *employees of the bankrupt*, and, therefore, is not entitled to priority within the plain meaning of § 64 (a) (4) of the Bankruptcy Act.

Under the Social Security Act, *supra*, the employer is required to deduct the tax assessed upon the employee from the employee's wages and remit to the United States Treasury Department. The employer is constituted a tax collector for the United States. The amount so collected or required to be collected becomes a debt owing to the United States instead of a tax due from the employer. In *Nolte* v. *Hudson Navigation Co.*, 8 F. (2d) 859, the United States claimed priority with respect to moneys which were collected by the Navigation Company under the provisions of Title 5 of the Revenue Act of October 3, 1917 (40 Stat. 314) and of the Revenue Act of 1918 (Comp. St. Ann. Supp. 1919, §§ 6309 1/3 a-6309 1/3 e). At page 862 therein the Court stated:

"Those acts imposed a tax upon persons and property for their transportation from one point in the United States to another. The language of the act is:

[1] Italics, when used, are our own.

'That the taxes imposed * * * shall be paid by the person, corporation, partnership, or association paying for the services or facilities rendered.' Section 501. It laid the duty of collecting the tax upon the carrier rendering the service, and made it the duty of the carrier to make monthly returns under oath, 'and pay the taxes so collected and the taxes imposed * * * to the collector [of internal revenue] of the district in which the principal office or place of business is located.' Section 503. And the act of 1918 declared that, 'if the tax is not paid when due, there shall be added as part of the tax a penalty of 5 per centum, together with interest at the rate of 1 per centum for each full month, from the time when the tax became due.' 40 Stat. 1103, § 502 (Comp. St. Ann. Supp. 1919, § 6309 1/3c)."

The United States contended there that the obligation of the Navigation Company was a tax obligation and consequently it was entitled to the lien afforded by § 3186 of the Revised Statutes. The Court, in holding that the Company's obligation was a debt and not a tax, said at page 862:

"It seems to us too clear for argument that the acts of Congress involved herein impose a tax upon the person transported or upon the shipper of freight to be carried. The tax is not imposed on the carrier but on the person or thing carried. And it is equally clear that the carrier is made a collector of the tax, and the duty is laid upon it to pay the amount which is thus collected to the collector of internal revenue of the district in which the carrier has its principal office or place of business.

"A tax is a pecuniary burden imposed for the support of government. The courts have said again and again that a tax is not a debt nor in the nature of a debt. It is not, as is a debt, founded on contract or agreement. It is an impost levied by authority of the government upon its citizens or subjects for the sup-

port of the state. The taxpayer is the one upon whom the pecuniary burden is imposed and whose duty it is to make payment. The burden of making payment here rests on the traveler or shipper. The duty of collecting it and then paying over the amount collected rests on the carrier it is true, but this does not make the carrier a taxpayer as distinguished from a tax collector."

In re York Silk Mfg. Co., 192 F. 81, the same doctrine was affirmed by the Circuit Court of Appeals in the Third Circuit. (Appeal dismissed for want of jurisdiction by this Court in 232 U. S. 718 and certiorari denied in 323 U. S. 724.) In that case the Circuit Court of Appeals said:

"By a statute of the state of Pennsylvania it is made the duty of the treasurer of a corporation, upon the payment of interest on any bond of the corporation, if the holder be a resident of Pennsylvania, to deduct from the interest the tax imposed by the state upon such bond and pay the same into the state treasury. This is a tax against the holder of the bond, and not against the corporation. The corporation, acting through its treasurer, is charged with the duty of collecting the tax and paying it over to the state. If it fails so to do, it becomes liable to the state for the amount of the tax and the penalty prescribed. * * * But there is nothing in the law giving to the state a preferred claim against the corporation whose treasurer has failed to collect the tax or to pay it over to the state."

The obligation of the bankrupt employer in the instant case was identical with that of the corporation in the *York* case, *supra*. The statute there made it the duty of the treasurer of the corporation, upon payment of interest on any bond of the corporation, to deduct from such interest the tax imposed by the State upon the bond and to pay the same into the State Treasury. Section 802 (a) of Title 8 which is here involved, requires the employer to deduct the amount of the tax from the wages of the taxpayer and

similar to the statute in the *York* case, upon failure so to do, it becomes liable for the payment of such tax.

See, also, *Colorado Bank* v. *Bedford*, 310 U. S. 41, where this Court held that a tax upon safe deposit rentals collected by a bank was not a tax upon the bank but upon customers of the bank.

In *Gulf Oil Corporation* v. *Grady*, 110 Fed. (2d) 178, the Court held that an estate of a bankrupt is not liable for the payment of a tax on gasoline bought from a distributor where the New York statute expressly declared that the distributor was to be the taxpayer. The claim was denied priority under § 64 of the Bankruptcy Act as amended, but was allowed as a general claim, the Court holding that "the debt which the bankrupts here owe the appellant is not one 'legally due and owing by the bankrupt * * * to any State'; for in any event, the bankrupt could not be considered the primary taxpayer."

The petitioner herein places such reliance upon the decision of this Court in *City of New York* v. *Feiring, supra*, that it claims the decision below should be reversed upon that authority. The *Feiring* case is clearly distinguishable from the situation presented herein. The *Feiring* case dealt with the New York City Sales Tax Act which by its terms imposed a tax both upon the vendor and the vendee. In our case, however, the tax is an income tax levied solely on the employee which is to be collected by the employer and paid by the employer to the Federal government. In our case, unlike the situation in the *Feiring* case, the tax is not levied upon both the employee and the employer. It is necessary to consider Title VIII of the Social Security Act in its entirety. Two taxes, separate and distinct, are levied under Title VIII, one an excise tax levied against

the employer based upon his payroll (§ 804) and the other an income tax levied against the employee based upon his wages in employment as defined (§ 801). Section 802 (a) describes the "employee" as the "taxpayer" of the tax imposed by § 801, and by its very terms constitutes the employer an insurer of collection and no more. Unlike the New York City Sales Tax Act where the incidence of the tax was, as this Court pointed out, laid jointly on the vendor and the vendee, the incidence of the tax imposed by § 801 is *solely* upon the employee.

Section 807 of the Federal Social Security Act [2] provides that the taxes imposed shall be collected by the Bureau of Internal Revenue under the direction of the Secretary of the Treasury and shall be paid into the Treasury of the United States as internal revenue collections.

Section 808, *ibid*,[3] provides that the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make and publish rules and regulations for the enforcement of this Title. Under this authority, in addition to regulation 91, Article 505, regulation 106, § 402.304 has been promulgated which provides that "Until collected from him the employee is also liable for the employees' tax with respect to all the wages received by him." Thus it is clear that the liability of the employee to pay his income tax is not dischargeable until the employer has collected it from the employee. We submit that the decision in the *Feiring* case is not applicable to the issue herein and that the obligation of the bankrupt employer is a debt and not a tax.

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[2] Superseded by § 1420 (a)-(b) Internal Revenue Code.

[3] Superseded by § 1429 Internal Revenue Code.

Conclusion.

For the above reasons, it is submitted that the judgment of the Circuit Court of Appeals should be affirmed with respect to the claim of the United States under §§ 801 and 802 (a) of the Social Security Act.

Respectfully submitted,

JOHN J. BENNETT, JR.,
Attorney General,
HENRY EPSTEIN,
Solicitor General,
WILLIAM GERARD RYAN,
Assistant Attorney General.

January, 1942.

APPENDIX.

Social Security Act, c. 531, 49 Stat. 620:

(U. S. C. Supp. V, Title 42, Sec. 1001.)

SECTION 801. In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum.

* * * * * * *

(U. S. C. Supp. V, Title 42, Sec. 1004.)

SEC. 802. (a) The tax imposed by section 801 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

* * * * * * *

(U. S. C. Supp. V, Title 42, Sec. 1004.)

SEC. 804. In addition to other taxes, every employer shall pay an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 811) paid by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum.

(2) With respect to employment during the calendar years 1940, 1941, and 1942, the rate shall be 1½ per centum.

(3) With respect to employment during the calendar years 1943, 1944, and 1945, the rate shall be 2 per centum.

(4) With respect to employment during the calendar years 1946, 1947, and 1948, the rate shall be 2½ per centum.

(5) With respect to employment after December 31, 1948, the rate shall be 3 per centum.

(U. S. C. Supp. V, Title 42, Sec. 1006.)

SEC. 807. (a) The taxes imposed by this title shall be collected by the Bureau of Internal Revenue under the direction of the Secretary of the Treasury and shall be paid into the Treasury of the United States as internal-revenue collections. If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 802 (b) and 805) at the rate of one-half of 1 per centum per month from the date the tax became due until paid.

* * * * * * * *

(U. S. C. Supp. V, Title 42, Sec. 1007.)

SEC. 808. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make and publish rules and regulations for the enforcement of this title.

* * * * * * * *

(U. S. C. Supp. V, Title 42, Sec. 1008.)

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by Act of June 22, 1938, c. 575, 52 Stat. 840:

SEC. 64. DEBTS WHICH HAVE PRIORITY.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined

by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such questions shall be heard and determined by the courts; * * *

* * * * * * *

(U. S. C. Supp. V, Title 11, Sec. 104.)

Treasury Regulations 91, promulgated under Title VIII of the Social Security Act:

ART. 505. *Assessment of underpayments.*—If any tax is not paid to the collector when due, the Commissioner may, as the circumstances warrant, assess the tax (whether or not the underpayment is otherwise adjustable) or afford the employer opportunity to adjust the underpayment pursuant to article 502 or 503. Unpaid employers' tax or employees' tax may be assessed against the employer. Employees' tax not collected by the employer may also be assessed against the employee. The unpaid amount, together with interest and penalty, if any, will be collected, pursuant to section 3184 of the United States Revised Statutes and other applicable provisions of law, from the person against whom the assessment is made. If any amount of an assessment has been previously reported and paid to the collector as an adjustment or otherwise, the person against whom the assessment is made is privileged to file with the collector a claim for abatement of such amount, together with interest and penalty thereon if included in the assessment. If an employer pays employees' tax pursuant to an assessment against him without an adjustment having been made pursuant to article 502, reimbursement is a matter to be settled between the employer and the employee. See article 602, relating to interest, and article 603, relating to penalty for failure to pay an assessment after notice and demand. See also article 601, relative to jeopardy assessments.

* * * * * * *

Treasury Regulations 106, promulgated under Sec. 1429 of the Internal Revenue Code:

SEC. 402.304. Collection of, and liability for, employees' tax.—The employer shall collect from each of his employees

the employees' tax with respect to wages for employment performed for the employer by the employee. The employer shall make the collection by deducting or causing to be deducted the amount of the employees' tax from such wages as and when paid, either actually or constructively. The employer is required to collect the tax, notwithstanding the wages are paid in something other than money (for example, wages paid in stock, board, lodging; see section 402.227) and to pay the tax to the collector in money. In collecting employees' tax, the employer shall disregard any fractional part of a cent of such tax unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent. The employer is liable for the employees' tax with respect to all wages paid by him to each of his employees whether or not it is collected from the employee. If, for example, the employer deducts less than the correct amount of tax, or if he fails to deduct any part of the tax, he is nevertheless liable for the correct amount of the tax. Until collected from him the employee is also liable for the employees' tax with respect to all the wages received by him. Any employees' tax collected by or on behalf of an employer is a special fund in trust for the United States. The employer is indemnified against the claims and demands of any person for the amount of any payment of such tax made by the employer to the collector.

Section 2707 of the Internal Revenue Code (see page 87 of these regulations) provides severe penalties for a willful failure to pay, collect, or truthfully account for and pay over, the employees' tax or for a willful attempt in any manner to evade or defeat the tax. Such penalties may be incurred by any person, including the employer, and any officer or employee of a corporate employer, or member or employee of any other employer, who as such employer, officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

No. 251

In the Supreme Court of the United States

OCTOBER TERM, 1941

IN THE MATTER OF INDEPENDENT AUTOMOBILE FORWARDING CORPORATION, BANKRUPT

STATE OF NEW YORK, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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JURISDICTION

The judgment of the court below was entered April 12, 1941 (R. 31). The petition for a writ of certiorari was filed July 9, 1941. The jurisdic-

tion of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Should the claim of the United States for social security taxes owed by a bankrupt be allowed in the amount computed by the mathematical formula approved by the courts below, or should it be reduced in accordance with a different formula presented by the bankrupt in order to give effect to the 90% credit provided in certain cases by Title IX of the Social Security Act?

2. Is the claim of the United States for social security taxes, computed in accordance with the formula approved by the courts below, a claim for a penalty of the type not provable under Section 57 (j) of the Bankruptcy Act?

STATUTES INVOLVED

Social Security Act, c. 531, 49 Stat. 621, 639:

> Title IX—Tax on employers of eight or more.
>
> Sec. 902. The taxpayer may credit against the tax imposed by section 1101 of this chapter the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law. The total credit allowed to a taxpayer under this section for all contributions paid into unemployment

funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only for contributions made under the laws of States certified for the taxable year as provided in section 1103 of this chapter. (U. S. C. Supp. V, Title 42, Sec. 1102.)

As amended by the Social Security Act Amendments of 1939, c. 666, 53 Stat. 1360, 1399, effective August 10, 1939, Section 902 of the Social Security Act provides:

(a) Against the tax imposed by section 901 of the Social Security Act [section 1101 of Title 42] for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law—

* * * * *

(3) Without regard to the date of payment, if the assets of the taxpayers are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

* * * * *

(i) No part of the tax imposed by the Federal Unemployment Tax Act or by title IX of the Social Security Act, whether or not the taxpayer is entitled to a credit

against such tax, shall be deemed to be a penalty or forfeiture within the meaning of section 57j of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, as amended. (U. S. C. Supp. V, Title 42, Sec. 1102 note.)

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544:

SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * * * *

(j) Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law. (U. S. C., Title 11, Sec. 93 (j).)

STATEMENT

The Independent Automobile Forwarding Corporation was adjudicated a bankrupt in the District Court for the Western District of New York on April 26, 1938 (R. 1). After liquidation of the property, the trustee had assets of $3,053.20, which were insufficient to pay in full the claims filed and allowed priority under Section 64 of the Bankruptcy Act (R. 5, 7–8, 13). The trustee accordingly filed a petition requesting directions from

the court as to the order of priority of the various claims (R. 6–9). Priority claims of the United States and of the State of New York are so large as to absorb the entire amount remaining in the hands of the trustee, irrespective of the outcome of this litigation (R. 13); accordingly, they are the only parties in interest in the proceeding.

Among the claims of the United States is one for taxes under Title VIII of the Social Security Act. The question whether this claim is entitled to priority is now pending before this Court on petition for a writ of certiorari, No. 238, filed by the Government. The decision in that proceeding will affect the amount of taxes collectible by each claimant, but the present petition is not otherwise dependent on the outcome of No. 238.

The instant petition is concerned with the manner in which the amount of social security taxes payable to the United States under Title IX of the Social Security Act should be computed. The method of computation presented by the United States involves the use of a mathematical formula which shows the percentage of the available funds to be applied to each claim.[1] The petitioner advo-

[1] By means of the formula, the total funds available for distribution (T) are equal to a certain percentage (X) of the total amount of taxes claimed by the State of New York (A) and by the United States (B), less the amount of the credit against the Title IX taxes (XA). The latter figure is equal to the amount of unemployment insurance taxes actually paid to the State, which is equivalent to the state's

cates the use of a different formula, which is described in detail in the petition and the appendix thereto. The petitioner maintains that the Government's method results in a partial disallowance of the 90% credit permitted by Section 902 of the Social Security Act, and that such denial amounts to the imposition of a penalty which would not be provable in bankruptcy.

The District Court approved the method of computation presented by the Government (R. 14–16) and its decision in this respect was affirmed by the Circuit Court of Appeals (R. 28–30).

ARGUMENT

1. The petitioner alleges that the Government's formula for computing the proportion of each claim to be paid out of the available funds deprives the taxpayer of the full 90% credit permitted by Section 902 of the Social Security Act. However, the Act does not authorize a credit of 90% of the

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claim (A) reduced by the appropriate percentage figure (X). The formula then takes the following form, when solved for X:

$$X=\frac{(A+B)-\sqrt{(A+B)^2-4(AT)}}{2A}$$

If the figures representing the appropriate tax claims are substituted for the above symbols, X will be found to equal 25.96%. If this percentage is applied to each claim, including the claim of the United States under Title IX reduced by the proportion of the state's claim for unemployment insurance allowed, the amounts approved by the District Court are obtained (R. 14).

taxes *assessable* under Title IX, as petitioner assumes. To the contrary, the credit is specifically limited to "the amount of contributions * * * *paid* by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law." [Italics supplied.] Section 902 of the Social Security Act, *supra*. Consequently, the credit may in no event amount to more than the sum actually paid to the state.

In the instant case, the amount to be paid to the state under the formula advocated by the Government is $858.42 (R. 14). In computing the payments to be made on the other priority claims, this $858.42 was deducted from the amount of the claim of the United States for taxes under Title IX of the Social Security Act. The latter claim, which amounted to $3,400.49 (R. 13), was thus reduced to $2,542.07. This sum was in turn reduced by application of the percentage found by the solution of the quadratic equation, namely, 25.967%. The resulting computation reveals that the sum of $660.10 should be paid on the claim of the United States under Title IX. The use of this formula constitutes an allowance of a credit, mathematically computed in an equitable manner, to the fullest extent permitted by the Act.

It is unnecessary to analyze in detail the alternative formula offered by petitioner, since the method used by the District Court and approved by the court below fully conforms to the statutory require-

ments. It may be noted, however, that petitioner's entire formula (Pet. 25) is based upon the assumption that the amount of credit to be allowed is 90% of the proportion of the bankrupt's assets available for payment of social security taxes to the United States without regard to the credit (if that amount does not exceed the amount paid to the state), rather than 90% of the tax imposed by the statute. This assumption is directly contrary to the statute. Section 902 of the Act specifically provides that the credit is to be taken against "the tax imposed" by Title IX. Under this statutory direction, it is plain that the credit is to be taken against the full amount of the claim of the United States for Title IX taxes. This being so, the amount of the credit must, of course, be determined by some formula such as that advanced by the Government before a computation may be made as to the amounts available for distribution to the various parties.[2]

2. Petitioner contends that 90% of the federal tax, computed without regard to the credit, consti-

[2] Stated otherwise, the amount available for distribution depends upon the amount of the credit, and the amount of the credit, in turn, depends upon the amount available for distribution, since the credit cannot exceed the amount actually paid to the state. As the court below pointed out (R. 28), the amount of the credit and the amounts available for distribution are thus "variables dependent upon each other" which cannot be computed by simple arithmetic, as petitioner seeks to do.

tutes a penalty for failure to pay an equal sum to the state, and accordingly that any claim for an amount greater than the remaining 10% of the tax is not provable under Section 57(j) of the Bankruptcy Act. The contention is untenable. Congress recognized that an employer who pays social security taxes to a state should be allowed to deduct the amount of that payment from his federal tax, since the Government's need for revenue for the purposes of the Act is *pro tanto* reduced. *Steward Machine Co.* v. *Davis,* 301 U. S. 548, 589. However, in order to prevent an undue competitive advantage to those employers who operate in states having no social security laws, or who fail to pay the taxes in full, the 90% credit is withheld in cases where no payment to the state is made. This does not result in the payment of more taxes, but merely assures an equal burden on all employers. The credit provisions involve no more of a penalty than the section of the revenue act which permits a deduction for gifts to charity. The higher taxes paid by those who fail to give represent simply the normal burden of taxation, not penalties.

In the instant case, the taxpayer is not required to pay increased taxes by reason of his payment to the state of a sum which is less than 90% of the United States' claim. To the contrary, the aggregate amount of all taxes paid will be less than the state's claim for unemployment insurance taxes

plus 10% of the claim of the United States for social security taxes under Title IX. There is, therefore, no substance to the allegation that the taxpayer is penalized.

In the two decisions of this Court cited by the petitioner as probably conflicting with the decision below (*Carter* v. *Carter Coal Co.*, 298 U. S. 238; *United States* v. *Constantine*, 296 U. S. 287), an extra tax burden was imposed upon taxpayers failing to comply with certain regulatory provisions contained in the particular statutes involved. Consequently, unlike the instant situation, the taxpayers in those cases would ultimately pay more if they violated than if they complied with the condition stated in the law.

The petitioner has cited several district court decisions as conflicting with the decision below (Br. 19). In those cases the denial of the 90% credit arose out of the failure of the taxpayer to pay the state taxes within the time required by law. However, the state taxes were paid after such date. Consequently, if the credit on the federal tax had not been allowed, those taxpayers would have paid more, in the aggregate, than if they had paid the state taxes within the time allowed. In such cases the denial of the credit partakes more of the nature of a penalty than it does in the case at bar, although the United States does not concede that even in such cases it should be

deemed a penalty. The distinction between the two types of situations was recognized by Congress in amending Section 902 of the Social Security Act on August 10, 1939. Section 902 (a), as amended, expressly provides that the credit should be allowed in full if the state contributions are paid, even though late, if the assets of the taxpayer were in the hands of a court during a designated period following enactment of the amendment.

Even if the tax involves a penalty, it is not the type of penalty referred to in Section 57 (j) of the Bankruptcy Act. In Section 902 (i) of the Social Security Act, as enacted on August 10, 1939, Congress expressly stated that the words "penalty or forfeiture" as used in the Bankruptcy Act do not include any part of the tax imposed by the Social Security Act, whether or not the taxpayer is entitled to a credit against such tax. The legislative history of this enactment shows plainly that it was not intended to effect a substantive change in the prior law, but was designed merely to set at rest the question presented in numerous pending cases. S. Rep. No. 734, 76th Cong., 1st Sess., p. 91.

CONCLUSION

The decision below is correct, and there is no conflict of authority. No sufficient reason has been shown for review, and the petition should therefore be denied.

Respectfully submitted.

CHARLES FAHY,
Acting Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
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AUGUST, 1941.

U. S. GOVERNMENT PRINTING OFFICE: 1941

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 251

STATE OF NEW YORK,

Petitioner,

vs.

THE UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOHN J. BENNETT, JR.,
Attorney General of the State of New York,
HENRY EPSTEIN,
Solicitor General of the State of New York,
Counsel for Petitioner.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 251

In the Matter of

INDEPENDENT AUTOMOBILE FORWARDING CORPORATION,

Bankrupt,

STATE OF NEW YORK,

Petitioner,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

May It Please the Court:

The petitioner, State of New York, respectfully shows to this Honorable Court:

Summary Statement of the Matter Involved.

The Independent Automobile Forwarding Corporation was adjudicated a bankrupt in the District Court for the Western District of New York on April 26, 1938. On the

same date, Claire M. Britt was duly appointed Trustee to liquidate the said corporation, and thereafter he duly qualified and acted, and still is acting, as such Trustee (R. 6). Trustee herein, by petition to the District Court, verified the 2nd day of May, 1939, showed that he had for distribution to priority creditors the sum of Three Thousand Fifty-Three and 20/100 ($3,053.20) Dollars (R. 7). The priority creditors are as follows:

State of New York for Unemployment Insurance Taxes	$3,305.82 (R. 8)
State of New York for Taxes under §§ 183 and 184 of the Tax Law	2,720.80 (R. 8)
U. S. Dept. of Int. Rev., 1937 Capital Stock Tax	307.13 (R. 8)
U. S. Dept. of Int. Rev., 1937 for Taxes under Titles VIII and IX of the Social Security Act	7,036.98 (R. 7)

The amount of Seven Thousand Thirty-six and 98/100 ($7,036.98) Dollars, above referred to, is for taxes under Title IX of the Federal Social Security Act (c. 531, 49 Stat. 639), amounting to Three Thousand Four Hundred and 49/100 ($3,400.49) Dollars (R. 13) and the balance of Three Thousand Six Hundred Thirty-six and 49/100 ($3,636.49) Dollars is for taxes under Title VIII of the Federal Social Security Act (c. 531, 49 Stat. 639). The State of New York requested the Trustee herein to object to 90% of the claim of the United States under Title IX of the Federal Social Security Act on the ground that it was a penalty and not provable against the bankrupt pursuant to § 57 (j) of the Bankruptcy Act. The Trustee filed his petition for instructions governing the payment of such priority claims, and an order thereon was made on June 23, 1939, by Honorable John Knight, District Judge for the Western District of New York, which order allowed the claims of the

United States in full. An appeal from this order was taken to the Circuit Court of Appeals for the Second Circuit by the State of New York. Thereafter, and on August 10, 1939, Congress enacted certain amendments to the Federal Social Security Act concerning the credit provisions of that Act in so far as they affected insolvent estates in the custody of courts of competent jurisdiction.

By stipulation dated June 9, 1939, between George L. Grobe, United States Attorney for the Western District of New York, Attorney for the United States, and John J. Bennett, Jr., Attorney General of the State of New York, Attorney for the State of New York, an order was made by Honorable Learned Hand, Presiding Judge of the Circuit Court of Appeals for the Second Circuit, discontinuing that appeal and remanding the case to the District Court for resettlement of its order of June 23, 1939, in accordance with the amendments to the Federal Social Security Act enacted August 10, 1939 (R. 10-12). The matter was then brought on before Honorable John Knight, District Judge, who made an order on July 21, 1940, allowing the claims filed herein in the following amounts (R. 4-6):

United States for Title IX taxes	$660.10
United States on all other tax claims	828.14
State of New York on its claim for unemployment insurance	858.42
State of New York on all other tax claims	706.53

The District Court held that the priority claims were to be paid on the basis of 25.967% thereof, using the following algebraic quadratic equation (R. 13-14):

$$X = \frac{(A\&B) \pm \sqrt{(A\&B)^2 - 4AT}}{2A}$$

The symbol "A" in the quadratic equation is used for the amount of the claim of the State of New York for unemploy-

ment insurance; the symbol "B" for the total of all other taxes; the symbol "T" for the total assets to be distributed; and, the symbol "X" for the percentage of distribution to be determined (R. 14).

An appeal from the order of Honorable John Knight, District Judge, dated July 21, 1940, was taken by the State of New York to the United States Circuit Court of Appeals for the Second Circuit. The Circuit Court of Appeals for the Second Circuit reversed the order of the District Court and remanded the cause for a determination of the amounts allowable on the claims of each of the claimants in accordance with its opinion (R. 30). The Circuit Court of Appeals sustained the contention of the State of New York that so much of the claim of the United States which represented taxes due pursuant to § 801 of Title VIII of the Federal Social Security Act was not a tax imposed upon the bankrupt, in that the bankrupt was liable only as an agent bound to pay whether its duty to collect was performed or not.

The court held that the liability of the bankrupt was a liability for a debt instead of taxes due and owing the United States and, therefore, did not form the basis of a claim entitled to priority under § 64 (a) (4) of the Bankruptcy Act (R. 27). The Circuit Court of Appeals overruled the contention of the State of New York that the bankrupt estate was entitled to a credit amounting to 90% of the claim of the United States for taxes under Title IX of the Social Security Act, and sustained the use by the District Court of the algebraic quadratic equation in arriving at the percentage of distribution (R. 30). It also overruled the contention of the State of New York that 90% of the claim of the United States under Title IX of the Social Security Act was a penalty and, therefore, not provable against the bankrupt estate pursuant to § 57 (j) of the Bankruptcy Act (R. 29).

Petitioner seeks a review by certiorari in this Honorable Court to determine whether, in a bankruptcy proceeding wherein a claim is made by the United States for taxes under Title IX of the Social Security Act, the estate is entitled to a credit not exceeding 90% of the claim of the United States for such taxes, and also, whether 90% of such tax, as imposed by § 901 of the Federal Social Security Act, is a penalty and, therefore, not provable against the bankrupt estate pursuant to § 57 (j) of the Bankruptcy Act.

Questions Presented.

The questions which are presented for review are:

1. Is the bankrupt entitled to a credit amounting to 90% of the claim of the United States for taxes under Title IX of the Social Security Act?

2. Is 90% of the tax imposed by § 901 of the Federal Social Security Act a penalty and, therefore, not provable against the bankrupt estate herein, pursuant to § 57 (j) of the Bankruptcy Act?

Reasons Relied Upon for Allowance of the Writ.

It is respectfully submitted by your petitioner and relied upon as reasons for granting of the writ that:

(a) The act of the Circuit Court of Appeals for the Second Circuit in holding that the bankrupt estate was not entitled to a credit amounting to 90% of the claim of the United States for taxes under Title IX of the Social Security Act defeats the purpose and scope of the Social Security Act and the Bankruptcy Act, as defined by Congress.

(b) The act of the Circuit Court of Appeals for the Second Circuit in holding that 90% of the tax imposed under § 901 of the Federal Social Security Act is not a

penalty defeats the purpose and scope of the Bankruptcy Act as defined by Congress.

(c) That the decision of the Circuit Court of Appeals for the Second Circuit has decided important questions of Federal law which have not been, but should be, settled by this Honorable Court.

(d) The Circuit Court's holding that 90% of the tax imposed under § 901 of the Federal Social Security Act is not a penalty is probably in conflict with the decisions of this Honorable Court in *United States* v. *Constantine*, 296 U. S. 287, and *Carter* v. *Carter Coal Co.*, 298 U. S. 238.

The decision of the Circuit Court of Appeals for the Second Circuit is of peculiar public interest and presents a fundamental question of law upon which there should be no diversity of opinion in the various United States District Courts' jurisdictions.

In the following cases, United States District Courts have upheld the contention that 90% of the tax assessed under Title IX was in fact a penalty:

In re Standard Composition Co. (U. S. Dist. Court, Eastern Dist. Mich., 1938), 23 Fed. Supp. 391;

In re Hy-Grade Meat & Grocery Co., (U. S. Dist. Court of N. J., 1938) 26 Fed. Supp. 294;

Matter of Hale Coal Co. (U. S. Dist. Court, Eastern Dist. of Pa.) not officially reported, but may be found in C. C. H. Unemployment Insurance Service, Vol. 1, p. 3722.

Matter of Evans Brewery, Inc. (U. S. Dist. Court, Northern Dist. of N. Y.), not officially reported but may be found in C. C. H. Bankruptcy Law Service, par. 51,372.

Matter of Gahran Buick Co. (U. S. Dist. Court, Northern Dist. of N. Y.), not officially reported, but may be found in C. C. H. Bankruptcy Law Service, par. 51,489.

Matter of D. O. Sommers Co. (U. S. Dist. Court, Northern Dist. of Ohio, Eastern Division, October, 1939), not officially reported, but may be found in Prentice-Hall Bankruptcy Service, p. 8478.

The District Courts in the following cases have held to the contrary:

Matter of Royal Wilhelm Furniture Co. (U. S. Dist. Court, Western Dist. Mich., 1938), 23 Fed. Supp. 993;
In re Illinois Art Industries (U. S. Dist. Court, Western Dist. Mich., 1939), 27 Fed. Supp. 334;
In re Rich Maid Creameries, Inc., (United States Dist. Court, Southern Dist. of Cal.), reversed on stipulation of parties, 97 Fed. 2d 992. We are not informed as to the reason for such stipulation.

That the uncertainty created by this conflict adversely affects the expeditious administration and closing of innumerable pending bankruptcy cases and will continue to so affect such cases and future bankruptcy cases until and unless this Court shall exercise its power of supervision and hear and determine the present question.

WHEREFORE, your Petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that court to certify and to send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket No. —, Matter of Independent Automobile Forwarding Corporation, Bankrupt, State of New York, Appellant *v.* United States of America, Appellee, and that the said decree of the Circuit Court of Appeals in the Second Circuit may be reversed by this Honorable Court, as prayed for by Peti-

tioner, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

July 8, 1941.

JOHN J. BENNETT, JR.,
Attorney General,
By HENRY EPSTEIN,
Solicitor General,
Attorneys for Petitioner.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 251

In the Matter of

INDEPENDENT AUTOMOBILE FORWARDING CORPORATION,

Bankrupt,

STATE OF NEW YORK,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinion Below.

The opinion of the District Court is reported in 35 Fed. Supp. 919 and is to be found at page 13 of the Record. The opinion of the Circuit Court of Appeals is reported in 118 F. (2d) 537 and is to be found at page 25 of the Record.

II.

Jurisdiction.

The date of the decree to be reviewed is April 12, 1941 (R. 31).

Jurisdiction of this Court is invoked under § 240 of the Judicial Code, 28 U. S. C. A. 347.

III.

Statement of the Case.

The essential facts of the case herein are stated in the accompanying petition for Writ of Certiorari and in the interest of brevity are not repeated herein.

IV.

Specification of Errors.

The Circuit Court of Appeals erred in the following particulars:

1. In failing to find and determine that the bankrupt estate was entitled to a credit amounting to 90% of the claim of the United States for taxes under Title IX of the Social Security Act.

2. In ordering that the claim of the United States for taxes under Title IX of the Social Security Act for the year 1937, filed in the amount of $3,400.49, be paid in the amount of $660.10 from the remaining assets in the bankrupt estate, and in failing to direct that the aforesaid claim be reduced by the amount of taxes due under the New York State Unemployment Insurance Law for the year 1937, but not to exceed 90% of the tax imposed under Title IX of the Social Security Act.

3. In failing to find and determine that 90% of the claim of the United States for unpaid taxes under Title IX of the Social Security Act for the year 1937,

constituted a penalty under the Bankruptcy Act and, therefore, was not allowable as a claim against the bankrupt estate.

V.

ARGUMENT AND AUTHORITIES IN SUPPORT OF PETITION.

Summary of the Argument.

Point A.

The bankrupt is entitled to a credit amounting to 90% of the claim of the United States for taxes under Title IX of the Social Security Act.

Point B.

The courts below, in limiting the credit to Eight Hundred Fifty-eight and 42/100 ($858.42) Dollars instead of allowing a credit of Three Thousand Sixty and 44/100 ($3,060.44) Dollars, thereby imposed a penalty.

Point A.

The bankrupt herein was adjudged a bankrupt on April 26, 1938, and since then the assets of the bankrupt have been in *custodia legis*.

During the year 1937, § 902 of the Social Security Act provided:

> "Sec. 902. The taxpayer may credit against the tax imposed by section 901 the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law. The total credit allowed to a taxpayer under this section for all contributions paid into unemployment funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only

for contributions made under the laws of States certified for the taxable year as provided in section 903."

Section 902 (a) of the Social Security Act, as amended, effective August 10, 1939, provides as follows:

"Sec. 902 (a) Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law—

(1) Before the sixtieth day after the date of the enactment of this Act;

(2) On or after such sixtieth day, with respect to wages paid after the fortieth day after such date of enactment;

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction."

Congress never intended that 90% of the tax levied under Title IX of the Social Security Act should be a source of revenue to the United States. On the contrary, the credit provided for in § 902, *supra*, was an inducement to State legislatures to enact unemployment insurance laws.

Steward Machine Co. v. *Davis*, 301 U. S. 548, 585;
Carmichael v. *Southern Coal and Coke Co.*, 301 U. S. 495, 525, 526.

The credit provision was enacted for the further purpose of inducing taxpayers to pay their State unemployment tax on time. The provision was, therefore, of a purely regulatory nature. It was known that as time went on the number of taxpayers who would fail to pay the State tax on time and thus obtain the Federal credit would eventually reach the vanishing point.

In fact, only 10% of the tax assessed under Title IX was designed as revenue producing. Revenue thus produced was not intended for the general support of the Federal Government, but it was intended to be turned back to the State to defray the cost of administering the unemployment insurance law. Title III of the Social Security Act provides for the payment to the States to cover the cost of administering its unemployment insurance law. Title IX assessed the tax to raise the funds for this purpose. It was determined after investigation that 10% of the tax assessed under Title IX was sufficient to cover this fiscal need.

The amount realized by the United States upon its claim under Title IX will tend to reduce the State's claim for unemployment insurance. Since the money paid the United States on its claim under Title IX will eventually be paid back to the State, by reason of the provisions of Title III, it is, therefore, more practical to pay it directly to the State on its unemployment insurance claim. Paying this money directly to the State on its unemployment insurance claim, in accordance with our theory, merely negatives the necessity of the United States granting the money back as *parens patriae.*

Unless the bankrupt estate is allowed such credit the United States will receive an unexpected windfall. On the other hand, the failure to give this bankrupt estate the credit will work a hardship upon its creditors, for they, in effect, will be forced to pay indirectly that portion of the credit that is not allowed, inasmuch as payment upon their claims will be reduced correspondingly.

A Bankruptcy Court is a court of equity and is governed by rules of equity jurisprudence.

Matter of Ben Boldt, Jr., Floral Co., 37 F. (2d) 499; 15 A. B. R. (N. S.) 543;

Continental Ill. Bank and Trust Company v. *Chicago, etc.*, 294 U. S. 648; 27 A. B. R. (N. S.) 715.

The court said in *in re Standard Composition Co.*, 23 Fed. Supp. 391, 395:

> "The Bankruptcy Act was drafted with the principle that 'equality is equity' in mind, but there has been a tendency in recent years for the typical bankruptcy proceedings to resolve itself into a process in which one preferred party after another slices off a portion of the available assets, with little or none remaining for distribution to general creditors."

It is only by the fortuitous circumstance of the insolvent having failed to pay his unemployment tax on time that the United States could, in the first instance, claim the full amount of the tax assessed under Title IX without allowing for the 90% credit. The United States has suffered no loss by the failure of the insolvent to pay his unemployment tax into a State fund within the required time.

As an illustration, let us assume that in the instant case the sum of Nine Thousand Five Hundred Fifty-five and 86/100 ($9,555.86) Dollars was available for distribution instead of Three Thousand Fifty-three and 20/100 ($3,053.20) Dollars. The United States could not deny that if the trustee had this larger amount all tax claims would be paid in full except the tax claim under Title IX, and that would be reduced by 90%, or, in other words, it would be allowed only in the amount of Three Hundred Forty and 05/100 ($340.05) Dollars. Yet, because this estate does not have Nine Thousand Five Hundred Fifty-five and 86/100 ($9,555.86) Dollars, but less than one-third that amount, the United States is requesting this Court to interpret the self-same laws in such an inequitable manner as to permit it to share in these meager assets in the amount of Six Hundred Sixty and 10/100 ($660.10) Dollars, or nearly 100% greater than it would admittedly be entitled to were the assets greater.

Thus, it being admitted that an insolvent estate that is fortunate enough to have sufficient funds to pay all taxes in full can obtain the full 90% credit under § 902a (3) of the Social Security Act, it follows as a matter of equity and good conscience that the less fortunate insolvent estate, which has insufficient funds to pay all taxes in full, should also be given the full 90% credit. There is no language in the enactment which would require a Bankruptcy Court to do violence to the equitable principles underlying the administration of insolvent estates, pursuant to the Bankruptcy Act, and require it to enrich one creditor (United States under Title IX) at the expense of other creditors.

Congress enacted § 902a (3) for the benefit of creditors of insolvent taxpayers in order to relieve the situation arising where the taxpayer had neglected to, or was financially unable to pay his unemployment tax into a State unemployment fund within the required time, in order to obtain the credit under Title IX of the Social Security Act. Before this enactment, the insolvent estate became liable for what then would amount to a double tax, since liability for the tax under Title IX became ten times greater than if the State unemployment tax had been paid on time. This burden fell not upon the insolvent taxpayer, but upon the creditors. It is apparent that Congress, having acted to correct this situation, must be assumed to have done so in an equitable manner.

It seems clear that subdivisions (1) and (2) of § 902a were enacted for the benefit of certain taxpayers who had hitherto failed to pay their State unemployment tax, in order to give them a new and additional limited period of time within which to pay delinquencies into State unemployment funds and still obtain the credit against the Federal tax. By this enactment it was hoped to encourage these taxpayers to pay delinquent contributions into State unem-

ployment funds without further delay, and further, to overcome the injustices arising from situations, where, in many instances, taxpayers had been ignorant of their liability or financially unable to pay until after the time in which credit could be taken had expired.

The same purposes, however, did not motivate the enactment of subdivision (3) of § 902a. That subdivision is not for the benefit of the taxpayer, but for the benefit of the creditors of the taxpayer. It does not extend the credit for a limited time only, but provides that an insolvent estate must be given the credit no matter how long a time has elapsed since the effective date of the amendment. It was not the purpose of this enactment to encourage payment by the insolvent estate of the unemployment tax without delay, since it must be presumed that Congress knew that such payment can be made only according to judicial procedure. Therefore, it may be seen that the purposes motivating the enactment of subdivisions (1) and (2) are quite different than the results sought to be obtained by the enactment of subdivision (3).

Therefore, once it is perceived that the intent behind the enactment of § 902a (3) was to correct an inequity which fell upon insolvent estates and creditors of insolvents, it is but one step further to perceive the equally apparent intent of Congress that *all* insolvent estates and all creditors of insolvents are to be accorded the same equitable treatment. To accomplish this Congress could only have intended that *all* insolvent estates which were in *custodia legis* at any time during the fifty-nine-day period beginning August 10, 1939, should be given the full 90% credit regardless of the amount of the State tax, or when payment is made into an unemployment fund under a State law.

Appellant submits that the correct solution for distribution in the instant case, under both the Bankruptcy Act and

the Social Security Act, as amended, appears in Appendix "A" hereto attached.

The explanation of the solution, as shown on Appendix "A," is that as soon as the sum of Seven Hundred Ninety-nine and 94/100 ($799.94) Dollars (Col. 3) is paid for unemployment insurance, the estate is entitled to a credit of 90% of Eight Hundred Twenty-two and 84/100 ($822.84) Dollars (Col. 3), which is the amount of the distribution on Title IX tax. Column "4" shows this 90% credit to be Seven Hundred Forty and 56/100 ($740.56) Dollars, which becomes a part of the estate and is available for further distribution. The 10% balance of the Title IX distribution then left is Eighty-two and 28/100 ($82.28) Dollars, as shown in Column "5." The sum of Seven Hundred Forty and 56/100 ($740.56) Dollars, which is now available for distribution, is distributed in accordance with the percentages in Column "2," producing the amounts indicated in Column "6." Thereafter, the same procedure is followed after each distribution until we get the final result showing ultimate payments, as above, in Column "37." Column "1" of the appendix sets forth the total amount of the State and Federal claims. The percentages in Column "2" are arrived at by dividing each creditor's claim by the total liabilities which, in this case, amount to Twelve Thousand Six Hundred Sixteen and 30/100 ($12,616.30) Dollars.

We consider this to be the equitable solution of the problem. By applying this solution the Title IX claim is not reduced in excess of the 90% credit.

While it is true that the difference between the application of the algebraic formula used by the District Court herein, and our simple arithmetical computations, amounts to the sum of One Hundred Ninety-seven and 67/100 ($197.67) Dollars, as the amount for unemployment insurance contributions, nevertheless, we urge that the appel-

lant's proposed solution (Appendix "A") be applied so that it may be used in other cases where, if this solution be authorized, general creditors would receive a dividend which they would not otherwise receive, and for the further reason that appellant's solution will work in every case including those cases where the amount of distribution for State unemployment insurance taxes exceeds the maximum 90% credit against the Federal tax under Title IX. In such a situation the application of the algebraic quadratic equation, as used in the court below, becomes impossible as a mathematical proposition.

Point B.

Section 57 (j) of the Bankruptcy Act provides:

> "Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued according to law." (11 U. S. C. A. Sec. 93 (j).)

During the year 1937, § 902 of the Social Security Act provided:

> "Sec. 902. The taxpayer may credit against the tax imposed by section 901 the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law. The total credit allowed to a taxpayer under this section for all contributions paid into unemployment funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only for contributions made under the laws of States

certified for the taxable year as provided in section 903."

Section 902 (i) of the Social Security Act, which was enacted on August 10, 1939, provides:

> "No part of the tax imposed by the Federal Unemployment Tax Act or by Title IX of the Social Security Act, whether or not the taxpayer is entitled to a credit against such tax, shall be deemed to be a penalty or forfeiture within the meaning of section 57 (j) of the Act entitled 'An Act to establish a uniform system of bankruptcy throughout the United States', approved July 1, 1898, as amended."

Section 902 (i), *supra,* was enacted on August 10, 1939, became effective immediately, and is not retroactive. In effect, the Section declares that the tax assessed under the Federal Unemployment Tax Act, for the years 1939 and thereafter, shall not be deemed a penalty within the meaning of § 57 (j) of the Bankruptcy Act. The United States tax under Title IX, *supra,* involved in this proceeding was assessed for the year 1937.

It is patent that the enactment of § 902 (i) of the Social Security Act was a studied attempt by Congress to overrule the numerous court decisions that had declared that 90% of the tax assessed under Title IX was in fact a penalty.

See in accord:

In re Standard Composition Co., 23 Fed. Supp. 391;

Matter of Evans Brewery, Inc., U. S. D. Ct., N. D. N. Y., Commerce Clearing House Unemployment Insurance Service, Vol. I, p. 3703;

Matter of Hale Coal Co., U. S. D. Ct., E. D. Pa., *Id.* p. 3722;

Matter of Gahran Buick Co., Inc., U. S. D. Ct., N. D. N. Y., *Id.* p. 3721;

In re Hy-Grade Meat & Grocery Co., 26 Fed. Supp. 294.

Contra:

Matter of Royal-Wilhelm Furniture Co., 23 Fed. Supp. 993;

In re Illinois Art Industries, 27 Fed. Supp. 334;

In re Great Northern Hat Co., Inc., Commerce Clearing House Unemployment Insurance Service, Vol. I, p. 3692; (by implication only; the Refere held the tax a penalty; the District Court reversed on other grounds).

In re Rich Maid Creameries, Inc., S. D. of Cal., decided Dec. 7, 1937; (reversed on stipulation of parties, 97 F. (2d) 992; we are not informed as to the reason for such stipulation).

It is submitted that if part of the tax under Title IX is *in fact* a penalty, merely stating that it is not a penalty will not accomplish that result. The label placed upon a measure by the legislature is not determinative of its true character.

In *Carter* v. *Carter Coal Co.*, 298 U. S. 238, the "Bituminous Coal Conservation Act of 1935" was under consideration. That Act imposed an excise tax on the sale of bituminous coal of 15% of the sale price at the mine, payable by the producers, provided, however, that any producer who filed with the Commission an acceptance of the code provisions, provided for in the Act, would be entitled to a drawback or credit equivalent to 90% of the tax. Concerning this provision the Supreme Court of the United States said at pages 288 and 289:

> "The so-called excise tax of 15 *per centum* on the sale price of coal at the mine, or, in the case of captive coal the fair market value, with its draw-back allowance of 13½%, is clearly not a tax but a penalty * * *.
>
> "* * * While the law maker is entirely free to ignore the ordinary meanings of words and make defi-

nitions of his own, *Karnuth* v. *U. S.*, 279 U. S. 231, 242; *Tyler* v. *U. S.*, 281 U. S. 497, 502, that device may not be employed so as to change the nature of the acts or things to which the words are applied."

Another case particularly applicable to the situation in the case at bar is *U. S.* v. *Constantine*, 296 U. S. 287. A provision of the Revenue Act of 1926 imposed a "special excise tax" of One Thousand ($1,000) Dollars in addition to the Twenty Five ($25.00) Dollars excise tax laid on retail liquor dealers who carried on such business contrary to local law. The Court in that case said at page 294:

> "The question is whether the exaction of $1,000 in addition, by reason solely of his violation of State Law, is a tax or a penalty? * * * In the Acts which have carried the provision, the item is variously denominated an occupation tax, an excise tax, and a special tax. If in reality a penalty it can not be converted into a tax by so naming it, and we must ascribe to it the character disclosed by its purpose and operation, regardless of name. Disregarding the designation of the exaction, and viewing its substance and application, we hold that it is a penalty for the violation of state law, and as such beyond the limits of federal power."

In *Matter of Standard Composition Co., supra*, the Court said at page 393:

> "The label placed upon an imposition in a revenue measure is not decisive in determining its character. Although called a tax, it may in fact constitute a penalty, and, if so, the courts will not shut their eyes to the fact but will give it the same legal effect as a penalty which is designated as such."

The Court, continuing, said at page 394:

> "I hold that Congress in enacting social security legislation did not intend to amend the Bankruptcy Act by implication. In the determination of the legality

and priority of federal tax claims, the Bankruptcy Act is paramount over other federal and state statutes. *Guarantee Title & Trust Co.* v. *Title Guaranty & Surety Co.*, 224 U. S. 152, 32 S. Ct. 457, 56 L. Ed. 706; *Missouri* v. *Ross*, 299 U. S. 72, 57 S. Ct. 60, 81 L. Ed. 46; * * *"

Therefore, § 902 (i) of the Social Security Act can not be deemed an amendment of § 57 (j) of the Bankruptcy Act, despite its apparent attempt so to do.

The attempt by Congress in § 902 (i) (Act of August 10, 1939, 53 Stat. 1399) to amend § 57 (j) of the Bankruptcy Act is wholly ineffective. The treatment accorded § 902 (i) by Referee Friebolin, Northern District of Ohio, Eastern Division, in a decision handed down in October 1939, immediately following the enactment of that Section, in *Matter of D. O. Sommers Co.* (reported in Prentice Hall Bankruptcy Service, page 8478) is pertinent. The referee stated in part as follows:

"This whole difficulty arises *only if* the Court should hold that credit upon the Federal tax up to 90% thereof, is not a penalty. If it *is a penalty*, then without regard to the amount *actually paid* upon the state tax, the Federal Tax will be allowed for 10% of the full (3%) amount."

The referee then proceeded to hold that it was a penalty, continuing as follows:

"The express provision in the Federal Act (Sec. 902i) that it shall not be deemed a penalty within the meaning of Sec. 57 (j) is not controlling. 25 C. J. 1178 and 61 C. J. 1516. *U. S.* v. *Constantine* ('35), 296 U. S. 287:

" 'If in reality a penalty it can not be converted into a tax by so naming it and we must ascribe to it the character disclosed by its purposes and operation regardless of name.' *U. S.* v. *Childs* ('24), 266 U. S. 304, 5 A. B. (N. S.) 5:

"'This Court has declined to give it (interest) peremptory definition * * * and it may be * * * that the latter word ("interest") would not save it from condemnation if it were in effect the former ("penalty") * * *.'

"I am aware of the several holdings in other jurisdictions, in some of which this provision for deduction up to 90% for failure of the debtor to pay, is held to be a penalty and in others not. But it is to be remembered that these decisions were rendered before the amendments of 1939 containing the saving clauses quoted above, which permits credit where bankruptcy occurred, upon payment by the trustee."

Congress, as well as many State Legislatures, has attempted to insert into tax legislation various provisions for increasing the amount of the tax where a taxpayer fails to pay on a day certain. Wherever such legislation has come before a Bankruptcy Court, so much of the exaction as exceeded legal interest has been held to be a penalty and not provable in bankruptcy. In *Matter of Pressed Steel Car Co.*, 100 F. (2d) 147, it was held that an assessment in a New Jersey statute, which provided that "interest" should be collected at the rate of 1% per month upon unpaid franchise taxes, was a penalty despite the label placed upon it and, therefore, not provable in bankruptcy. To the same effect, see *In re Denver* v. *R. G. W. R. Co.*, 27 Fed. Supp. 983, and *In re Semon*, 11 Fed. Supp. 18.

In *Matter of James Butler Grocery Co.*, 22 Fed. Supp. 998, the bankrupt accepted unlawful rebates in buying milk, and after being given notice by the State Agriculture Department of a hearing for revocation of its license, it agreed to pay the amount of the rebates to the State in installments and the Department agreed not to hold the hearing. The Court held the payments were penalties within the meaning of § 57 (j) of the Bankruptcy Act, since the State sustained no pecuniary loss.

In like manner the United States, in the instant case, sustained no pecuniary loss by the failure of the bankrupt-taxpayer to pay the unemployment insurance tax to the State of New York on a day certain. In fact, the United States sustains no pecuniary loss if a taxpayer never pays a State unemployment insurance tax. It is, therefore, submitted that the failure to allow the credit on the tax imposed under Title IX of the Social Security Act is a penalty *in fact*, despite any declaration to the contrary in § 902 (i) of that Act.

Conclusion.

It is respectfully submitted that this case calls for the exercise by this Court of its supervisory power. The subject matter of this petition is of great importance because it affects the administration of innumerable bankruptcy estates. If the conflict in opinion between the various district courts continues to exist, the expeditious closing of many bankruptcy estates will be forestalled by the uncertainty created thereby. This Honorable Court has not as yet had the occasion to construe the effect of the provisions of § 902 of the Social Security Act with respect to its effect upon § 57 (j) of the Bankruptcy Act. We respectfully pray that this Honorable Court take jurisdiction in the premises herein.

Dated: July 8, 1941.

JOHN J. BENNETT, JR.,
Attorney General.
By HENRY EPSTEIN,
Solicitor General,
Attorneys for Petitioner.

APPENDIX (A).

Arithmetical Computations of Distribution Pursuant to Sections 902, 903A of Social Security Act—and Section 64A (4) of the Bankruptcy Act.

	1	2	3	4	5	6	7	8	9	10	11	12	13
Creditor	*Creditor's Claim*	*Percentage of Equity in Assets*	*Amt. Due Creditor 1st Payment*	*Credit 90% of Title 9 Payment*	*10% of Title 9 Payment*	*Distribution of 2nd Payment*	*Col. 3+ Col. 6*	*10% of Title 9 Payment*	*90% of Title 9 Payment*	*Balance of Title 9 Col. 5+ Col. 8*	*Distribution of 3rd Payment*	*Col. 7+ Col. 11*	*10% of Title 9 Payment*
Unemployment Insurance	$ 3,305.82	$ 26.20	$ 799.94	$	$	$ 194.03	$ 993.97	$	$	$	$ 47.06	$ 1,041.03	$
Title 9	3,400.49	26.95	822.84	740.56	82.28	199.58	281.86	19.96	179.62	107.08	48.41	151.65	4.84
Other Federal Taxes	3,189.19	25.28	771.85			187.21	959.06				45.41	1,004.47	
Other State Taxes	2,720.80	21.57	658.57			159.74	818.31				38.74	857.05	
Total Liabilities	$12,616.30	$ 100%	$ 3,053.20 (Total Available Assets)			$ 740.56	$ 3,053.20	$	$	$	$ 179.62	$ 3,053.20	

	14	15	16	17	18	19	20	21	22	23	24	25
Creditor	*90% of Title 9 Payment*	*Balance of Title 9 Col. 10+ Col. 13*	*Distribution of 4th Payment*	*Col. 12+ Col. 16*	*10% of Title 9 Payment*	*90% of Title 9 Payment*	*Balance of Title 9 Col. 15+ Col. 18*	*Distribution of 5th Payment*	*Col. 17+ Col. 21*	*10% of Title 9 Payment*	*90% of Title 9 Payment*	*Balance of Title 9 Col. 20+ Col. 23*
Unemployment Insurance	$	$	$ 11.42	$ 1,052.45	$	$	$	$ 2.77	$ 1,055.22	$	$	$
Title 9	43.57	107.08	11.74	118.82	1.17	10.57	108.25	2.85	111.10	2.29	2.56	108.54
Other Federal Taxes			11.01	1,015.48				2.66	1,018.14			
Other State Taxes			9.40	866.45				2.29	868.74			
Total Liabilities			$ 43.57	$ 3,053.20				$ 10.57	$ 3,053.20			

	26	27	28	29	30	31	32	33	34	35	36	37
Creditor	*Distribution of 6th Payment*	*Col. 22+ Col. 26*	*10% of Title 9 Payment*	*90% of Title 9 Payment*	*Col. 25+ Col. 28*	*Distribution of 7th Payment*	*Col. 27+ Col. 31*	*10% of Title 9 Payment*	*90% of Title 9 Payment*	*Col. 30+ Col. 33 Balance of Title 9*	*Distribution of 8th Payment*	*Total Final Distribution Col. 32+ Col. 36*
Unemployment Insurance	$ .67	$ 1,055.89	$ .07	$	$	$ .16	$ 1,056.05	$	$	$	$ .04	$ 1,056.09
Title 9	.69	109.23		.62	108.61	.17	108.78	.02	.15	108.63	.04	108.67
Other Federal Taxes	.65	1,018.79				.16	1,018.95				.04	$ 1,018.99
Other State Taxes	.55	869.29				.13	869.42				.03	869.45
Total Liabilities	$ 2.56	$ 3,053.20				$ .62	$ 3,053.20				$ .15	$ 3,053.20

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SUPREME COURT OF THE UNITED STATES.

Nos. 238 and 251.—October Term, 1941.

United States of America, Petitioner, 238 vs. State of New York.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.
State of New York, Petitioner, 251 vs United States of America.	

[March 2, 1942.]

Mr. Justice Byrnes delivered the opinion of the Court.

The United States and the State of New York seek review of a judgment of the Circuit Court of Appeals for the Second Circuit reversing in part a District Court order for the distribution of the assets of a bankrupt estate. The Independent Automobile Forwarding Corporation was adjudicated a bankrupt on April 26, 1938. A total of $3053.20 eventually became available for distribution. This amount was insufficient even to meet those claims of the federal and state governments which were assertedly entitled to priority as taxes under § 64(a)(4) of the Bankruptcy Act.[1] The federal claims of this character were for amounts due under §§ 801 and 802 of Title VIII and under § 901 of Title IX of the Social Security Act,[2] and for certain taxes as to which

[1] "Section 64. Debts which have priority.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be . . . (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof . . . ." U. S. C., Title 11, §104.

[2] C. 531, 49 Stat. 636, 639.

"Section 801. Income tax on employees. In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of wages (as defined in § 811) received by him after December 31, 1936, with respect to unemployment (as defined in § 811) after such date: (1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum." U. S. C., Title 42, § 1001.

"Section 802. (a) The tax imposed by § 801 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages

no question is raised in this case. The state claims were for payments due its unemployment insurance fund, and for taxes not in issue here.

The state's appeal from the District Court's first order of distribution was discontinued by agreement of the parties because the Social Security Act had been extensively amended while the appeal was pending.[3] A second order was thereupon entered by the District Court. The state again appealed to the Circuit Court of Appeals. It contended that the share of the assets granted to the federal government was excessive for three reasons: (1) the claim based on § 801 of Title VIII of the Social Security Act was a claim for a debt rather than for taxes and thus was not entitled to priority under § 64(a)(4) of the Bankruptcy Act; (2) no more than 10% of the claim based on § 901 of Title IX of the Social Security Act was entitled to allowance because the balance constituted a claim for a penalty rather than a tax and thus fell within the prohibition of § 57(j) of the Bankruptcy Act;[4] and (3) the credit against the Title IX claim provided for in §902 was incorrectly calculated. The Circuit Court of Appeals sustained the state's contention with respect to the Title VIII claim and reversed to that extent the order of the District Court, but rejected the state's arguments with respect to the claim under Title IX.

First. The claim based on Title VIII. Section 801 bears the heading "Income tax on employees" and provides for a tax "upon the income of every individual" equal to 1 per

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as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer." U. S. C., Title 42, § 1002.

"Sec. 901. On and after January 1, 1936, every employer (as defined in § 907) shall pay for each calendar year an excise tax, with respect to having individuals in his employ, equal to the following percentages of the total wages (as defined in § 907) payable by him (regardless of the time of payment) with respect to employment (as defined in § 907) during such calendar year: . . . (2) with respect to employment during the calendar year 1937 the rate shall be 2 per centum. . . ." U. S. C., Title 42, § 1101.

[3] C. 666. 53 Stat. 1360, 1399. See notes 9 and 10, *infra*.

[4] "Section 57(j). Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law." U. S. C., Title 11, § 93(j).

centum of the wages received by him with respect to employment during 1937.[5] Section 802(a) provides that this tax "shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid." The employer is made liable for the payment of the tax. By regulation, pursuant to Title VIII,[6] the Treasury Department has explicitly ruled that the tax may be assessed against the employer, regardless of whether he has in fact deducted it from the employee's wages. The Circuit Court held that the employer was liable "only as an agent bound to pay whether its duty to collect was performed or not" and that his liability was for a debt rather than for taxes.

As authority for this view it relied upon its decision of the same date in *City of New York* v. *Feiring*, 118 F. 2d 329. The city sales tax involved in that case was laid upon receipts from sales of personal property. The vendor was required to collect the amount of the tax from the vendee separately from the sales price. He was obliged to report periodically concerning his receipts from sales and to turn over to the City Comptroller the taxes due, whether or not he had actually collected them from the purchasers. If the vendor failed to collect the tax, the vendee was required to report the transaction and to pay the tax directly. Thus, the procedure contemplated was that the purchaser should bear the burden of the tax, but that the seller should collect and transmit it to the Comptroller. If the seller did not obtain it from the purchaser, however, the Comptroller was authorized to proceed to collect it from either of them. The Circuit Court of Appeals held that the claim of the City against a bankrupt vendor for the amount of the sales tax outstanding was a claim for a debt and not for taxes, within the meaning of § 64(a)(4). We reversed this decision and held that the burden imposed upon the seller by the city taxing act had "all the characteristics of a tax entitled to priority" under § 64(a)(4). 313 U. S. 283.

We think that our decision in the *Feiring* case is controlling here. The New York City sales tax involved in that case and the obligation imposed by §§ 801 and 802 of Title VIII of the Social Security Act cannot be distinguished in any material

[5] Both the pertinent state and federal claims are for the year 1937.

[6] Treasury Regulations 91, Article 505.

respect. It was observed in the *Feiring* case that while the sales tax was intended to rest upon the purchaser "in its normal operation", "both the vendor and the vendee are made liable for payment of the tax *in invitum* . . . and the tax may be summarily collected by distraint of the property of either the seller or the buyer." 313 U. S. 283, at 287. The burden of the tax provided for by §§ 801 and 802 likewise will normally rest upon the employee, but the Commissioner of Internal Revenue may proceed to collect it from the employer whether or not he has deducted it from the wages of the employee.

Two distinctions between the cases are urged by the State. One is that § 802(a) of Title VIII provides that the tax "shall be collected by the employer of the taxpayer" and thus reveals a Congressional intent that only a claim against the employee should be treated as one for a tax. The other asserted distinction is that Title VIII in its entirety is designed to impose two distinct taxes; § 801 imposes an "income tax" upon the employee, while § 804 imposes an "excise tax" upon the employer.[7] But a tax for purposes of § 64(a)(4) includes any "pecuniary burden laid upon individuals or property for the purpose of supporting the government," by whatever name it may be called. *New Jersey* v. *Anderson*, 203 U. S. 483, 492. Although he may not be referred to in §§ 801 and 802 as the taxpayer, and although he may also be subject to the "excise tax" prescribed by § 804, the plain fact is that the employer is liable for the § 801 tax whether or not he has collected it from his employees. We therefore hold that the Title VIII claim of the United States against the estate of this bankrupt employer is entitled to the priority afforded by § 64(a)(4).

Second. The claim under Title IX. Section 901 imposes upon this employer, in addition to the obligations discussed above, an "excise tax" equal to 2 per centum of the total wages payable by him during 1937. Section 902, however, permits him to credit "against the tax imposed by § 901" the amount of his

[7] "Section 804 Excise tax on employers. In addition to other taxes, every employer shall pay an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in § 811) paid by him after December 31, 1936, with respect to employment (as defined in § 811) after such date: (1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum.". U. S. C., Title 42, § 1004.

1937 contributions to the State unemployment fund, but provides that the total credit "shall not exceed 90 per centum of the tax against which it is credited."

(a) The State contends that § 902(a) in effect exacts a penalty, equal to 90% of the amount of the tax levied by § 901, from an employer who fails to make the payments to the State unemployment fund required by state law. Since § 57(j) of the Bankruptcy Act provides that claims by the United States for penalties are not allowable,[8] it argues, only 10% of the tax imposed by § 901 is actually a tax for purposes of § 64(a)(4) of the Bankruptcy Act. There is no merit to this contention. While the issue here is cast in somewhat different terms, it is similar in outline to that raised by the constitutional objection to the Act which was set to rest in *Steward Machine Co.* v. *Davis*, 301 U. S. 548. There it was argued that the 90% credit provisions amounted to coercion of the States which was repugnant to the Tenth Amendment and to the federal system. The Court recognized that the effect of the scheme was to encourage the States to establish and maintain unemployment insurance funds and thus to cooperate with the federal government in meeting a common problem. It observed that "every rebate from a tax when conditioned upon conduct is in some measure a temptation" but it concluded that "to hold that motive or temptation is equivalent to coercion is to plunge the law in endless difficulties", and to accept "a philosophical determinism by which choice becomes impossible." 301 U. S. at 589-590. These considerations are equally pertinent to the suggestion that the 90% rebate arrangement constitutes the imposition of a "penalty" within the meaning of § 57(j) upon an employer who fails or refuses to contribute to a state fund. The amount of the tax assessable under § 901 is definite and fixed, once the single variable, the total of the wages paid during the year, is determined. Although the employer is free to obtain a credit against it by contributing to his state fund, it cannot be said that it is any the less a tax because the employer has failed, either through choice or lack of resources, to make such a contribution. Either the state or the federal government must provide the money to meet the requirements of relief to the unemployed. By his contributions to the state, an employer has diminished the demand

[8] See note 4, *supra*.

upon the financial resources of the federal government. But by his failure to contribute, the employer has increased this demand and sharpened the necessity for obtaining the revenues required to satisfy it. The effort by the United States to obtain the revenue by denying the credit must be regarded as the levying of a tax and not as the exaction of a penalty.[9]

(b) Finally the state contends that the District Court applied an incorrect formula in determining the amount of the credit deductible under § 902. Section 902 provides: "The taxpayer may credit against the tax imposed by § 901 of this chapter the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year)[10] into an unemployment fund under a State law. The total credit allowed to a taxpayer under this section for all contributions paid into unemployment funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited . . ." In the case of a bankrupt who has not made any contribution to the state unemployment fund at the time of adjudication and whose assets are insufficient to meet the total of the claims of equal priority, the calculation of the credit is beset with some difficulty. The amount available for the state's claim for its unemployment insurance fund is contingent upon the sums allowed on the other claims, including that of the federal government under § 901. The amount to be allowed on the claim of the United States is in turn dependent upon the credit deductible from it under the terms of § 902. And this credit under § 902 is determined by the sum granted on the state's unemployment insurance fund claim.

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[9] In 1939 Congress undertook to put an end to any doubts on this question by providing in § 902(i) of the amendments to the Social Security Act that no part of the tax imposed by Title IX should be deemed a penalty or forfeiture within the meaning of § 57(j) of the Bankruptcy Act. C. 666, 53 Stat. 1360, 1400.

[10] This condition had not been complied with in the present case. However, the 1939 amendments to the Social Security Act, which resulted in the dismissal of the first appeal by stipulation, provided that the credit should be allowed on payments to the state fund "without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction." § 901(a)(3). C. 666, 53 Stat. 1360, 1399. This bankrupt estate qualified under this provision.

Because of this mutual dependence the courts below have accepted and approved an algebraic solution of the problem. Under this solution the claim for the tax assessed under § 901 is diminished by subtracting from it an amount equal to the sum allowed to the State for its unemployment fund. The formula by which this is accomplished is reducible to a quadratic equation capable of solution by the recognized method.

As against this algebraic solution, the State urges an arithmetical calculation which would afford it a larger share of the assets. In brief, the state's theory is as follows: The amount of each of the several claims of the State and of the United States should be divided by ~~the sum of the assets available~~ the total of such claims. The percentage of the assets due on each claim is thus determined. The total of the assets available is then multiplied in turn by these percentages, and the actual sum to be allowed on each claim is found. However, the amount allowed on the federal government's claim under § 901 is then multiplied by 10%. The sum equal to this 10% is thereupon conclusively granted to the United States. But the remaining amount, equal to 90%, is returned to the estate as a second fund to be divided among all the claims in the same manner. The share of this second fund which by this computation would go to the United States on its § 901 claim is again multiplied by 10%, with the balance of 90% returning to form a third fund. The process is repeated until the still undistributed assets reach a vanishing point.

It will be observed that while the one solution is algebraic and the other arithmetic, there is little to choose between them in terms of complexity. The obvious fact is that neither the Bankruptcy Act nor the Social Security Act afford the courts any meaningful assistance in solving the problem raised by this case. And their legislative history is equally barren.

The State objects to the formula applied below because its effect is to accord the United States a larger sum in dollars and cents on its §901 claim than it would receive if the available assets were sufficient to discharge in full all of the priority claims. This is true because, under § 902, the United States would be entitled to no more than 10% of its § 901 claim if the unemployment fund claim of the State was paid in full. We agree that this result is somewhat incongruous. However, the method of computation urged by the State embodies so basic

an error that we cannot accept it. Section 902 permits the credit "against the tax imposed by § 901." Under the State's formula the credit is reckoned in terms of a sum determined by that formula to be *actually available* to the United States on its § 901 claim rather than in terms of the whole amount *actually due* under that section. We think that the words "the tax imposed" must mean "the tax demanded" or "assessed" or "due". It can hardly be thought to mean "the tax paid" or "the amount available for payment of the tax". The formula adopted by the District Court avoids this error by crediting the undetermined sum available to the state unemployment fund against the total tax assessed or claimed under § 901. We therefor hold that the District Court and the Circuit Court of Appeals did not err in adopting and using that formula.

The judgment of the Circuit Court of Appeals is reversed with respect to the claim under Title VIII, but is otherwise affirmed. The case is remanded to permit the reinstatement of the judgment of the District Court.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.